PROPERTY COUNCIL of Australia

In partnership with

AEAS Australian Economic Advocacy Solutions

Measuring the economic impact of Victoria's foreign purchaser additional duty and absentee owner surcharge

VIC Division
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Contents

Executive summary

Foreign investment is vital to the Victorian property market, with international investors helping to fund the extra homes and businesses needed to cater to a rapidly growing population.

On 1 July 2015 the Victorian Government introduced a new 3 per cent surcharge on stamp duty for foreign investors purchasing residential property in Victoria referred to as the Foreign Purchaser Additional Duty (FPAD). The Victorian Government has since increased the surcharge to 7 per cent on 1 July 2016 and again to 8 per cent from 1 July 2019.

In addition, an Absentee Owner Surcharge (AOS) of 0.5 per cent was introduced 1 July 2015. The Victorian Government has since increased the surcharge to 1.5 per cent on 1 July 2016, 2 per cent on 1 July 2019 and then doubled it to 4 per cent on 1 July 2023.

Foreign investment in real estate can and has been identified to bring significant benefits to Victoria including economic growth; job creation; infrastructure development; increased property values (non-demand driven); technological transfer; tax revenue; improved housing supply; cultural exchange and diversity; and revitalisation of neighbourhoods.

At the same time, many of the myths relating to foreign investment in residential property have been debunked by Reserve Bank of Australia and the Commonwealth Treasury. From a comprehensive literature review, there is little in the way of empirical evidence to support claims foreign residential investment has adversely impacted affordability of residential property in Victoria. Indeed what the literature review does reveal is the opposite. Foreign investment in residential property has added to housing stock increasing supply and in turn placing a downward pressure on house prices.

This outcome is largely as a result of the fact that foreign investors are required to gain approval from the Foreign Investment Review Board (FIRB) prior to acquiring an interest in Australian real estate, and applications are considered in light of the overarching principle that the proposed investment should increase Australia's housing stock by creating at least one new additional dwelling.

Based on analysis of FIRB and Commonwealth Treasury statistics, the introduction of FPAD and AOS have had a significant negative impact on foreign investment in the Victorian housing market. The number of foreign investor supplied dwellings in Victoria fell from 12,524 to 10,997 in 2014-15, as a result of the implementation of the FPAD and AOS. The number of foreign investor supplied dwellings then collapsed in 2016-17 to just 3,403 when the FPAD was increased to 7 per cent and the AOS increased to 1.5 per cent (a 72.8 per cent reduction over two years). On every occasion there has been an increase in either the FPAD or AOS since, there has been a corresponding decline in the number of foreign investor supplied dwellings.

The value of foreign investor supplied dwellings in Victoria has also collapsed from $10.1 billion in 2014-15 to just $3.3 billion by 2016-17 as a result of the implementation of the FPAD and AOS and their increases to 7 per cent and 1.5 per cent from 1 July 2016. In 2022-23, the latest year of available data from the Commonwealth Treasury confirms there was just $2.1 billion in value of approvals in 2022-23, down $8 billion or 79.5 per cent since 2014-15.

Foreigners seeking to purchase real estate as an investment have a broad market across different countries, with investment decisions typically based on expected returns. By placing such a surcharge through FPAD and AOS the Victorian Government has decreased the attractiveness of Victoria's residential property to potential foreign buyers.

Loss in foreign investor supplied dwellings in Victoria (number)

Source: FIRB and Australian Government Treasury

Cumulatively over the period since the implementation of the FPAD (and also the AOS), Victoria has theoretically lost an estimated 81,598 new or refurbished dwellings worth approximately $63.9 billion.

The losses in economic activity and employment as a result of FPAD and AOS are significant. AEAS modelling indicates the reduction in the level of foreign investment in Victoria residential property has led to:

Reduction in Victoria's GSP (Gross State Product):

$7.5 b to $12.2 b

reduction in Victoria's GSP for 2023-24 compared to 2014-15 levels.

$57 b to $93 b

net loss to the Victorian economy from 2015-16 to 2023-24.

$6.8 b to $11.2 b

due to FPAD.

$700 m to $1 b

due to AOS.

Reduction in Victorian employment for 2023-24 compared to 2014-15:

55,397 to 90,951

fewer jobs in Victorian employment.

50,577 to 83,038

lost jobs attributed to FPAD.

4,820 to 7,913

lost jobs attributed to AOS.

Other key findings include:

Existing exemptions are no longer contextually current and workable. For example, AOS exemption guidelines that set out to offer respite to businesses have manifested as a complex web of limitations, hindering their effectiveness. The exclusion of absentee trusts or corporations operating as landlords or property investors has created a disconnect between the exemption's intent and its application.

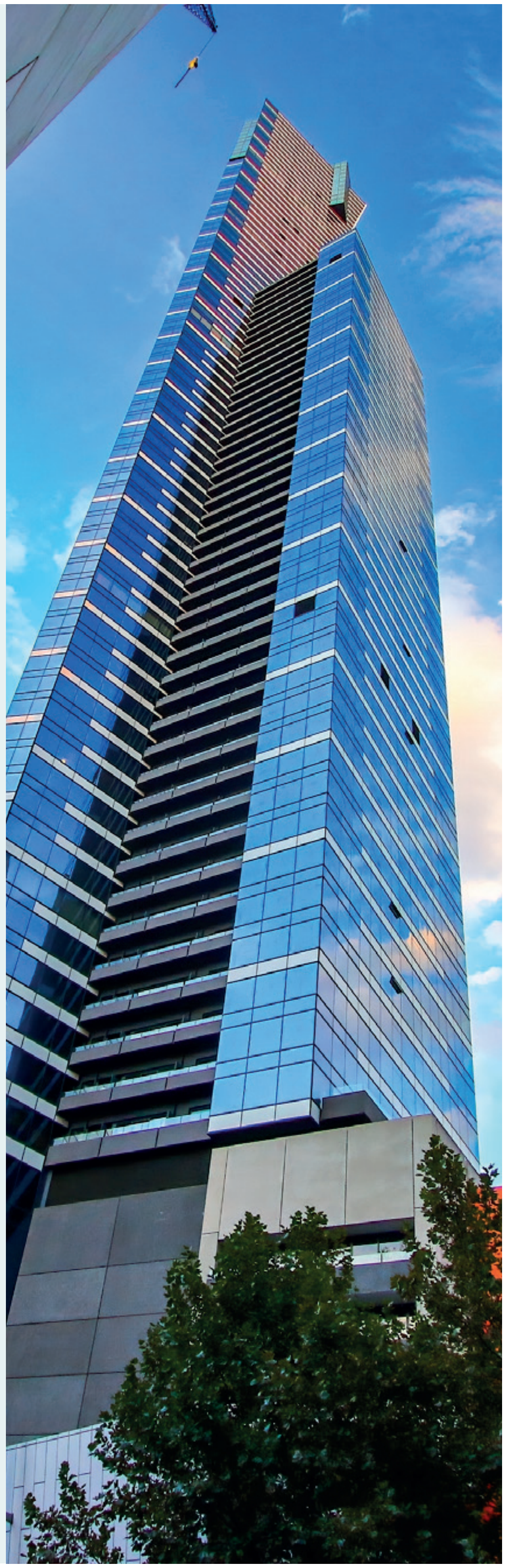
Global investors in new real estate are viewing Victoria as having more stringent, complex and costly regulatory and tax policy settings compared with other developed markets.

Victoria's population growth will require significant investment in real estate and infrastructure to ensure our State remains both liveable and continue to be engines of economic prosperity. We will need more homes, offices, retail centres, industrial sites, retirement living, student accommodation, hotels and community, cultural and sporting precincts.

Without strong and stable flows of international capital, the pressure to fund these significant investments will fall back to governments and will put further strain on government budgets and ultimately taxes. Or worse as we are already seeing, many investment opportunities in Victorian real estate will be delayed or not proceed and Victorians will simply not have the real estate assets needed to sustain our quality of life.

Analysis of commercial real estate indicates an established and significant reduction in foreign investment in Victorian commercial real estate. Over the period 2013-14 to 2019-20, there has been an average loss of foreign investment each year of $1.468 billion. The average value of the foreign investment per approval over this period is $49 million and compares to average foreign investment for each residential real estate approval of $885,200. This highlights the high importance foreign investment in commercial real estate as it has a significantly higher worth and is equally sensitive to FPAD and AOS.

Victoria is in competition with other States for property investment and when coupled with a range of other uniquely regressive taxes, PFAD and AOS are likely to be placing Victoria at a competitive disadvantage.



PFAD and AOS rates by state (%)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
PFAD	8.0	8.0	7.0	0.0	7.0	8.0	0.0	0.0
AOS	4.0	4.0	2.0	0.0	0.0	2.0	0.0	0.75

Source: Interstate comparison of taxes 2023-24, NSW Treasury

There is a lack of transparency around the revenue raised from FPAD and AOS, however, based on the extent of the reduction in foreign investment, FPAD and AOS has actually reduced the overall revenue the Victorian Government receives in property taxes.

Based on a dramatic reduction in foreign owned property transactions each year and the loss of normal stamp duty and land tax that prospective purchasers otherwise would have paid, over the period **2015-16 to 2023-24** the Victorian Budget is worse off by a net **$194 million** compared against the counterfactual base of no foreign property taxes being introduced. In **2023-24**, the Victorian Budget is worse off by a net **$38.8 million** as a result of FPAD and AOS compared against the counterfactual base of no foreign property taxes being introduced.

The Victorian Government has taxed foreign investors to the point whereby the tax revenue they are contributing under FPAD and AOS has fallen and will continue to fall. Not only has FPAD and AOS been lost, but so too has broader general transfer duty and land tax.

Foreign investment brings with it tangible benefits to our local economy and raising the FPAD to 8 per cent and the AOS to 4 per cent provides considerable risk of further disincentivising foreign investment in Victoria's residential property market, reducing the contribution of these investors to economic activity in Victoria that goes well beyond the potential revenue gains for the State Government.

Recommendations

The Property Council believes that Vacant Residential Land Tax as it applies to foreign owners is the appropriate mechanism to ensure existing housing stock is fully utilised to the benefit of potential Victorian home buyers and renters. Accordingly, the Property Council recommends the following:

01	The Foreign Purchaser Additional Duty (FPAD) of 8 per cent should be removed or reduced.
02	The Absentee Owner Surcharge (AOS) of 4 per cent should be removed or reduced.
03	The Victorian Treasury should undertake an urgent and thorough review of the current Victorian exemption guidelines. A review is crucial to undertake an expansion of the guidelines to ensure that all businesses, regardless of their developmental or operational stages, can be considered for an AOS exemption.
04	The Victorian Treasury should adopt moving thresholds and duty rates to adjust for rising property prices to ensure revenue neutrality for government and cost neutrality for developers, home buyers and owners.
05	The Victorian Government should have a no new tax or increased tax on property policy.
06	The Victorian Government through COAG should work with other States and the Commonwealth to implement a new tax reform agenda that as a commencement considers the unactioned recommendations from the last Henry Review of Taxes.
07	Australian Treasury recommence reporting the number and value of foreign investment approvals in commercial real estate by State.

01 Introduction and overview

Foreign investment is vital to the Victorian property market, with international investors helping to fund the extra homes and businesses needed to cater to a rapidly growing population.

On 1 July 2015, the Victorian Government introduced a new 3 per cent surcharge on stamp duty for foreign investors purchasing residential and commercial property in Victoria referred to as the Foreign Purchaser Additional Duty (FPAD). The Victorian Government has since increased the surcharge to 7 per cent on 1 July 2016 and again to 8 per cent from 1 July 2019.

At the same time, the Absentee Owner Surcharge (AOS) was introduced - an extra tax, on top of regular land tax, that foreign property owners have to pay in Victoria if they don't live in Australia. The AOS was initially set at 0.5 per cent in 2015, however since then, it has been increased to 1.5 per cent in 2016, 2 per cent in 2019, and then doubled to 4 per cent on 1 July 2023.

Table 1
FPAD and AOS tax rates by financial year (%)

	Foreign purchaser additional duty (%)	Absentee owner surcharge (%)
2015-16	3.0	0.5
2016-17	7.0	1.5
2017-18	7.0	1.5
2018-19	7.0	1.5
2019-20	8.0	2.0
2020-21	8.0	2.0
2021-22	8.0	2.0
2022-23	8.0	2.0
2023-24	8.0	4.0

Source: State Revenue Office Victoria

The introduction of FPAD has had a significant impact on foreign investment in the Victorian housing market. In June 2018 the Property Council of Australia commissioned research to measure the impact of FPAD on the Australian (including Victorian) market, with this research indicating:

- A marked decline in foreign investor demand for residential property in 2016-17 compared to the three preceding years, which coincided with the introduction of surcharges in key States where foreign residential investment has been focused.
- Approvals for foreign residential purchases fell 67.1 per cent nationally.

The implementation of the Absentee Owner Surcharge (AOS) and its increases to 4 per cent have compounded these losses.

Australian Economic Advisory Services (AEAS) was commissioned by the Property Council to update the June 2018 report specific to Victoria. More specifically, AEAS through this report has updated the following key metrics for the period 2015-16 through to 2023-24 including:

- Number and value of foreign investment approvals for new and existing dwelling purchases in Victoria;
- Number and value of foreign investment approvals for Victorian commercial real estate, and
- The level of foreign investment that would have occurred without the surcharges, and how many new homes that could have been built over this period with that investment.

The coming months in build up to the 2025-26 Victorian Budget represents a crucial opportunity for discussion about the right taxes to have in Victoria that will assist in providing large long-term economic gains through the Victorian property industry.

AEAS through this report has objectively analysed the impact and importance of foreign investment to the Victoria's residential and commercial real estate and the economy.

02 Methodology

2.1 Previous research

The economic contribution estimates presented in this report are measured based on original estimates produced by AEC Group report 'Economic modelling of the contribution of the property industry '(AEC, 2018') and work AEAS prepared for the Property Council of Australia (Queensland Division) in early 2024. The model developed was combined with data from a range of sources, including State and National Accounts data and various industry specific data from the ABS. The Input-Output models were used to produce estimates of the direct and flow on contribution of the property industry to the Victoria economy in terms of output, gross product and employment.

2.2 Updated methodology

AEAS has examined the economic and employment importance of foreign investment in Victoria's residential development sector and the loss of this contribution since the implementation and progressive increases in both the FPAD and AOS. The report was developed in close consultation with Property Council of Australia - Victoria Division.

Using existing research as a starting point, AEAS determined the impact of the introduction and subsequent increase of FPAD and AOS on foreign investment in the Victorian residential market though the following methodology:

- AEAS established the annual foreign investment in Victoria's residential development (both investment value and number of dwellings) from 2013-14 to 2022-23 from Foreign Investment Review Board (FIRB) and Commonwealth Treasury data with estimates produced for 2023-24.
- Using pre-FPAD trends (namely 2014-15) AEAS estimated what the foreign investment year on year (both investment value and number of dwellings) would have been had the Victorian Government not introduced the FPAD and AOS and calculated the loss in state economic activity and jobs since the introduction of FPAD and subsequent introduction of the AOS.
- AEAS applied original economic and employment contributions per foreign investment to updated FIRB approvals following FPAD and AOS implementation to recalculate economic and employment contributions now occurring and losses compared against original contributions.

AEAS notes that FIRB and Commonwealth Treasury data are likely to represent an upper limit on the actual level of foreign investment in Australia, since not every approval granted by FIRB results in a property sale to a foreign investor or temporary resident. Despite limitations, FIRB approvals are the main source of data on the level of foreign residential investment in Australia and given the extent of the additional cost now imposed for foreign investors this point is now not as prominent (i.e. if approval is provided the foreign investor is likely to push ahead).

Analysis by the Reserve Bank of Australia and ANZ Research (2017) has applied an assumption of between 30 per cent and 50 per cent of all approvals being actioned. This study uses these proportions and accordingly is considered quite conservative given the point above.

Finally AEAS analysed FIRB annual reports to analyse approval numbers for foreign investment in Victorian commercial property.

2.3 Report sections

This report contains the following sections:

- Section three and four discusses the benefits of foreign investment in Victorian residential and commercial property and seeks to dispel many myths relating to it;
- Section five examines historic investment by foreigners in Victorian residential property and the establishes the foundation data set to be used for analysis;
- Section six outlines the history of the FPAD and AOS in Victoria and its subsequent impact on foreign residential investment approvals and value;
- Section seven assesses the economic contribution of foreign residential investment to the Victorian economy and subsequent losses arising from the FPAD and AOS; and
- Section eight provides analysis in relation to foreign investment in commercial real estate and section nine provides discussion and analysis regarding the potential risks associated with the Victorian Government's retention of and any further increases to FPAD and AOS.

03 Benefits of foreign investment in residential and commercial property

The foreign investment framework aims to channel foreign investment into new dwellings. The FIRB states that this can create additional jobs in the construction industry, help support economic growth, and increase government revenues in the form of stamp duties and other taxes. The Australian Government's Foreign Investment Policy states that foreign investment enhances the wellbeing of Australians by increasing production, employment and income.

Foreign investment in real estate can and has been identified to bring significant benefits to both Victoria and the investors themselves. Benefits include:

Economic growth

Foreign investment injects significant capital into the Victorian economy, which can stimulate economic growth and development. The level of investment by foreign investors in Victoria's dwelling stock, in particular new dwellings, has been an important driver of construction and market activity. Without this investment there would be a considerable softening in new dwelling development. At its peak foreign investment in Victoria in 2014-15 was estimated to contribute between $8.7 billion and $14.3 billion to Victoria's Gross State Product (GSP).

Job creation

Real estate projects funded by foreign investors and developers can create jobs in construction, architecture, engineering, property management, maintenance, and related industries. Again, at its peak, foreign investment in Victorian residential property in 2014-15 was estimated to create between 64,743 and 106,256 jobs.

Infrastructure development

Investments in Victorian real estate have often included ancillary infrastructure improvements such as roads, utilities, parks and public facilities, which have benefited the local community and enhancing overall quality of life for residents. This infrastructure has either been directly provided by the developer or paid for by infrastructure charges to Council.

Increased property values (non-demand driven)

Foreign investment can lead to improved property values in the surrounding areas due to renovations, upgrades, and overall economic development. Please see section 4 which discusses the neutral impact foreign investment has had on Victorian property values from a demand perspective.

Technological transfer

Foreign investors have brought new technologies, construction techniques and design concepts that improve efficiency in housing production and management practices that has enhanced efficiency and innovation in Victoria's real estate sector.

Tax revenue

The Victorian Government has previously benefited from increased tax revenue generated from property taxes, income taxes from new jobs, and other related taxes. These funds have been used to improve public services such as schools, healthcare, and public safety. Section 7.2 details how excessive foreign property taxes have had a negative impact on revenue to the Victorian Budget due to foreign participation in Victoria's property market collapsing.

Improved housing and rental supply

In markets facing housing and rental shortages such as Victoria, foreign investment has helped increase the supply of housing units, thereby helping alleviate housing shortages, providing more options for residents and addressing housing and rental affordability issues. Foreign investors have provided capital for real estate development projects that increased Victoria's overall housing and rental stock. This has included funding for new residential buildings, affordable housing projects, or mixed-use developments. Foreign investment is vital to the Victorian property market, with international investors helping to fund the extra homes and businesses needed. These benefits can specifically be seen in the rental sector, with foreign investors funding critical rental stock, in turn driving down rents and providing safe and affordable homes for Victorians.

Cultural exchange and diversity

Foreign investment can bring cultural diversity to Victorian communities, as investors and tenants from different countries and backgrounds contribute to the local social fabric. This has enriched Victoria's community life through cultural events, cuisine, and new perspectives.

Revitalisation of neglected areas

In some cases, foreign investment targets neglected or underdeveloped areas, leading to urban revitalisation. This can transform previously underutilised neighbourhoods into vibrant, desirable places to live and work. Recent examples include Brisbane's Spring Hill, Fortitude Valley, Teneriffe, Newstead and Bowen Hills.

04 Dispelling myths relating to foreign investment in residential property

A key driver for Victoria introducing a surcharge on foreign residential purchases was the significant growth in foreign investment experienced between 2012-13 to 2014-15. Public concerns were raised regarding the potential impact of foreign investors on property prices and housing affordability, in particular in Australia's major cities where foreign investment is strongest.

From a comprehensive literature review, there is little in the way of empirical evidence to support claims foreign residential investment has adversely impacted affordability of residential property in Victoria. Indeed what the literature review does reveal is the opposite – that is it has placed downward pressure on house prices.

Public concerns were raised regarding the potential impact of foreign investors on property prices and housing affordability, in particular in Australia's major cities where foreign investment is strongest.

Key conclusions from the Reserve Bank of Australia and Commonwealth Treasury include:

The majority of approvals have been granted for investment into new, as opposed to existing dwellings. This suggests that foreign demand is being channelled into increasing the property supply as intended.

Reserve Bank of Australia

While some commentators have argued that foreign demand is pricing out first home buyers, it is not clear that this is the case. Foreign demand has accounted for only a small proportion of the increase in property prices in recent years.

Commonwealth Treasury

The data and liaison suggest that foreign residential investment is concentrated in some parts of the housing market, though not generally in the parts where first home buyers have a major presence. While it is difficult to know the counterfactual, purchases by foreign residents and construction by foreign developers have probably resulted in a somewhat higher stock of housing in Australia than would otherwise have been the case, although by a magnitude that is difficult to determine.

Overall, the available data suggest that while foreign residential purchases change a bit from year to year, they have been relatively steady and fairly low as a share of turnover in the housing market in Australia and hence are unlikely to have been the main driving factor behind the recent increase in prices.

Reserve Bank of Australia

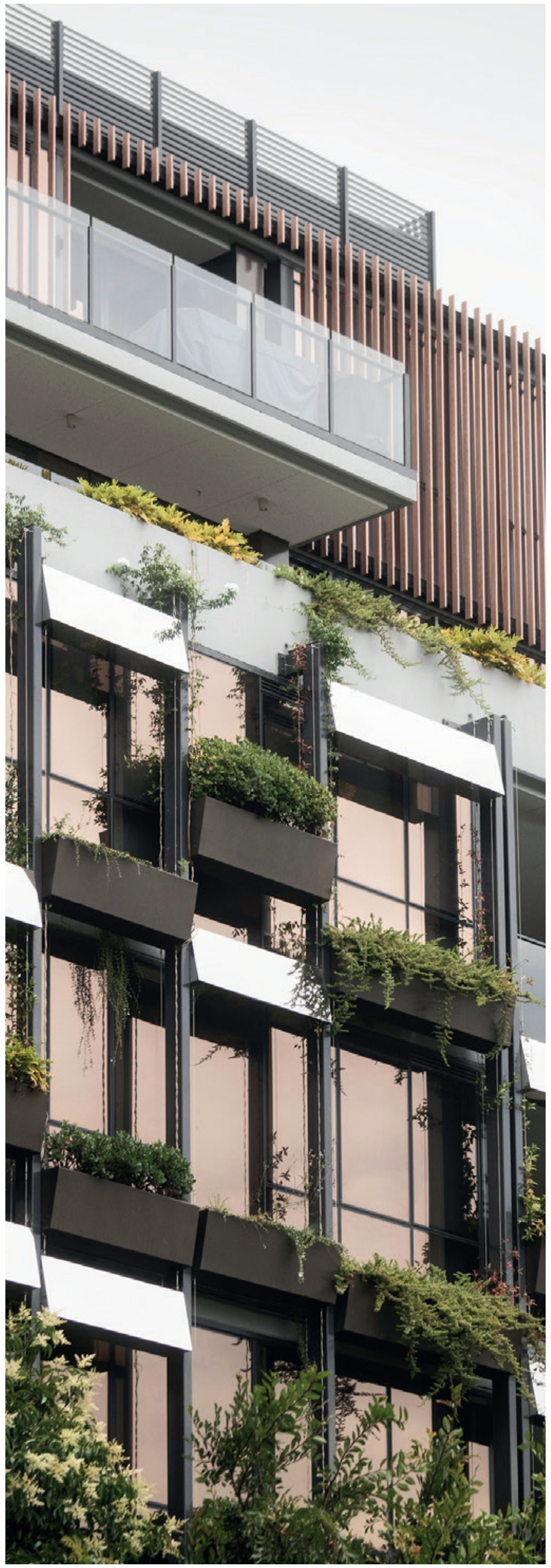
In principle, the residency of a developer should make little difference to the magnitude of the supply response following an increase in demand for new housing. In practice, foreign developers may introduce new technology and skills to the Australian market and increase competition. In addition, foreign developers often fund projects using offshore financing, which diversifies the source of funding and at times may increase the overall level of funds available for dwelling investment in Australia.

Reserve Bank of Australia

ANZ Research (2017) notes foreign investors have been an important contributor to both Victoria and Australia's recent construction activity. However, foreign investors comprise only a small share of the national and state housing stock (estimated to own between 2.5 per cent to 4 per cent of all dwellings in Australia), while around 5 per cent of housing stock is transacted each year. At these rates foreign investors are not the primary driver on residential price movements, though can be integral to stabilising property demand during periods of market weakness as Victoria and Australia have recently experienced.

Foreign buyers have supported dwelling investment through the current cycle, but have not been the main cause of the rapid price growth and are unlikely to be the cause of a sharp price correction.

ANZ Research



05 Foreign investment in residential property data

Foreign investment has been a longstanding feature of Victoria's housing market. Foreign investors are required to gain approval from the Foreign Investment Review Board (FIRB) prior to acquiring an interest in Australian real estate, and applications are considered in light of the overarching principle that the proposed investment should increase Australia's housing stock by creating at least one new additional dwelling.

More specifically, Australia's foreign investment laws cover three broad groups: foreign developers of new residential projects; foreign purchases of new dwellings; and temporary resident purchases of new and established dwellings. In short:

- Foreign-developed new residential projects are permitted and the resultant dwellings can be sold to either foreign or domestic buyers;
- Foreign individuals and temporary residents are permitted to purchase any new dwelling; and
- Temporary residents with visas that allow them to stay in Australia for a continuous period of more than 12 months (such as some foreign students and people on skilled business visas) are permitted to purchase one established home provided it is used as their principal place of residence while in Australia and is sold once vacated. Foreign persons who own residential property are required to pay an annual vacancy fee if their property is not residentially occupied or genuinely available for rent for more than 183 days (approximately six months) during a year.

Furthermore:

- Approval for an acquisition of vacant land for residential development is generally on the construction being completed within four years and the land not being sold until the construction is complete;
- Approval for an acquisition of a new (or near-new) dwelling is not usually subject to any conditions concerning its usage;
- Property developers looking to sell their newly developed dwellings to foreign persons can also apply for foreign investment approval on behalf of their foreign customers. Where a developer holds such an approval, the foreign person will generally not need to seek their own foreign investment approval.

Table 2

Number and value of foreign investment approvals for new and existing dwelling purchases, Victoria

Foreign investment type	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
New dwellings										
Approvals (no.)	4,613	8,435	10,281	2,663	2,455	2,247	1,943	1,985	953	1,461
Value ($m)	2,850.0	5,410.0	6,870.0	2,010.0	1,700.0	1,600.0	1,430.0	1,500.0	744.2	1,202.7
Existing dwellings										
Approvals (no.)	3,483	4,089	716	740	1323	956	466	235	428	458
Value ($m)	3,200.0	4,710.0	3,340.0	1,290.0	451.5	340.6	763.6	382.7	711.3	867.5
Vacant land										
Approvals (no.)	1,536	3426	1336	1872	681	565	806	537	322	321
Value ($m)	790.0	1,260.0	1,470.0	600.0	1,300.0	899.7	280.8	280.8	121.8	126.4
Total dwellings (excl vacant land)										
Approvals (no.)	8,096	12,524	10,997	3,403	3,778	3,203	2,409	2,220	1,381	1,919
Value ($m)	6,050.0	10,120.0	10,210.0	3,300.0	2,151.5	1,940.6	2,193.6	1,882.7	1,455.5	2,070.2

Source: FIRB and Australian Government Treasury

As a result of all foreign buyers requiring approval to purchase Australian property, the FIRB publishes data annually on the total number and value of the approvals it grants to foreign investors and temporary residents for the purchase of a specifically identified property or piece of land. This data is provided in table 2 and has been used as the foundation data for this report's analysis.

The data confirms that of the approved property purchases, the majority are for new dwellings and / or vacant land across all years for which data is available. This in turn highlights the vast majority of foreign interest in residential property is for development of new property.

06 History of Victoria's FPAD and AOS and their impact

6.1 History of FPAD

On 1 July 2015, the Victorian Government introduced a new 3 per cent surcharge on stamp duty for foreign investors purchasing residential property in Victoria referred to as the Foreign Purchaser Additional Duty (FPAD). The Victorian Government has since increased the surcharge to 7 per cent on 1 July 2016 and again to 8 per cent from 1 July 2019. (see table 1 for more information).

6.2 History of AOS

An Absentee Owner Surcharge (AOS) of 0.5 per cent was introduced 1 July 2015. The Victorian Government has since increased the surcharge to 1.5 per cent on 1 July 2016, 2 per cent on 1 July 2019 and then doubled it to 4 per cent on 1 July 2023 (see table 1 for more information).

6.3 Impact of FPAD and AOS on approvals

Based on analysis of FIRB and Commonwealth Treasury statistics, the introduction of FPAD and AOS have had a significant negative impact on foreign investment in the Victorian housing market. It is not possible to draw a 100 per cent causative link to the introduction of FPAD and AOS as there are multiple factors that may influence applications. However the extraordinary decline in approvals for foreign residential purchases since the introduction of FPAD on 1 July 2015 in Victoria is apparent and startling, as is the reduction that occurred when the AOS was introduced.

The number of foreign investor supplied dwellings in Victoria fell from 12,524 in 2014-15 to 10,997 as a result of the implementation of the FPAD and AOS. The number of foreign investor-supplied dwellings then collapsed in 2016-17 to just 3,403 when the FPAD was increased to 7 per cent and the AOS increased to 1.5 per cent (a 72.8 per cent reduction over two years).

On every occasion there has been an increase in either the FPAD or AOS since, there has been a corresponding decline in the number of foreign investor-supplied dwellings. In 2022-23, the latest year of available data, the Commonwealth Treasury confirms there were just 1,919 approvals, down 10,605 from 2014-15.

6.4 Impact of FPAD and AOS on approved values

The value of foreign investor supplied dwellings in Victoria has also collapsed from $10.1 billion in 2014-15 to just $3.3 billion by 2016-17. Whilst it is not possible to conclude with certainty, the collapse in number of dwellings from 2014-15 to 2016-17, can likely be a result of the implementation of the FPAD and AOS, and their increases to 7 per cent and 1.5 per cent from 1 July 2016. In 2022-23 the latest year of available data from the Commonwealth Treasury confirms there were just $2.1 billion in the value of approvals in 2022-23, down $8 billion or 79.5 per cent since 2014-15.

Figure 1

Loss in foreign investor supplied dwellings in Victoria (number)

Source: FIRB and Australian Government Treasury

Figure 2

Loss in foreign investor supplied dwellings in Victoria ($ billions)

Source: FIRB and Australian Government Treasury

6.4 Shortcoming of exemptions

The exemption guidelines that set out to offer respite to businesses have manifested as a complex web of limitations, hindering their effectiveness. The exemption guidelines were last reviewed and updated in 2018 and place the discretionary power of exemption with the Treasurer, empowering the Treasurer to grant reprieve to Australian-based corporations or trustees that demonstrate a significant contribution to the Victorian economy and community, and exhibit good corporate behaviour.

However, the exemption guidelines have inadvertently created barriers for Australian-based commercial property owners to access exemptions. Specifically, the exclusion of absentee trusts or corporations operating as landlords or property investors has created a disconnect between the exemption's intent and its application. The disconnect between developmental and operational phases poses a practical challenge, as an exemption granted during development may cease once operations commence.

6.5 The role of the vacant residential land tax

Vacant residential land tax (VRLT) now applies to residential land that is vacant for more than 6 months in the preceding calendar year. Residential land includes:

- land with a home on it;
- land with a home which is being renovated or where a former home has been demolished and a new home is being constructed; and
- land with a home on it that has been uninhabitable for 2 years or more.

The Victorian Government introduced VRLT from 1 January 2018 to help address the lack of housing supply in Victoria.

VRLT is assessed by calendar year (1 January to 31 December) and the owner of the property is liable for it. VRLT is different to land tax, the absentee owner surcharge and the federal annual vacancy fee.

From 1 January 2025, VRLT will apply to residential land across all of Victoria if the land is vacant for more than 6 months in the preceding calendar year. Prior to 1 January 2025, it applied only to vacant residential land in inner and middle Melbourne.

From 1 January 2025, a progressive rate of VRLT applies to non-exempt vacant residential land across all of Victoria. VRLT is calculated on the capital improved value (CIV) of taxable land. The CIV of a property is the value of the land, buildings and any other capital improvements made to the property as determined by the general valuation process. It is displayed on the council rates notice for the property. The rate of VRLT is based on the number of consecutive tax years the land has been liable for VRLT and is:

- 1 per cent of the CIV of the land for the first year the land is liable for VRLT where the land was not liable for VRLT in the preceding tax year;
- 2 per cent of the CIV of the land where the land is liable for VRLT for a second consecutive year; and
- 3 per cent of the CIV of the land where the land is liable for VRLT for a third consecutive year.

In addition, unimproved residential land in metropolitan Melbourne that has remained undeveloped for at least 5 years and is capable of residential development may attract VRLT from 1 January 2026 onwards.

Property industry feedback indicates that this is the appropriate mechanism and not FPAD nor AOS to ensure existing or potential housing stock is utilised to the fullest extent.

6.6 Overall impacts

Foreigners seeking to purchase real estate as an investment have a broad market across different countries, with investment decisions typically based on expected returns. By placing such a surcharge the Victorian Government is decreasing the attractiveness of Victoria's residential property to potential foreign buyers.

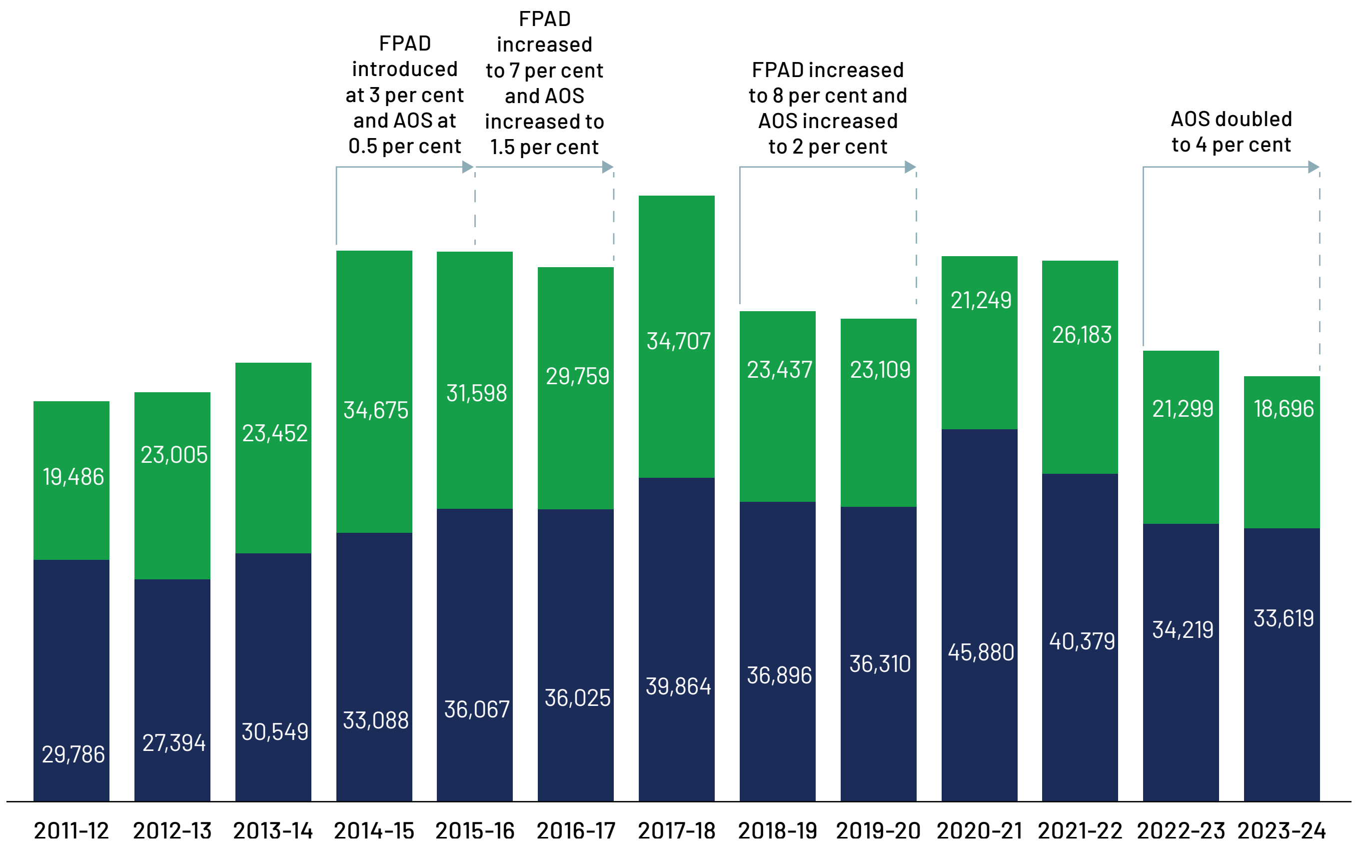
Cumulatively over the period since the implementation of the FPAD, Victoria has theoretically lost an estimated 81,598 new or refurbished dwellings worth approximately $63.9 billion. The implementation of FPAD and its increase together with the announcement of AOS and their commensurate reduction in foreign investment in Victorian real estate have coincided with significant reductions in the number of Victoria building approvals.

Very importantly, the trend that has occurred in Victoria is almost identical to other states (New South Wales and Queensland) that have also introduced a surcharge on stamp duty for foreign purchases of residential property. The New South Wales (4 per cent) surcharge came into effect on 1 July 2016 as did the Queensland Government (3 per cent).

Since then, New South Wales has increased its to 8 per cent (now 9 per cent) and the Queensland Government has since increased the surcharge to 7 per cent and again to 8 per cent from 1 July 2024. South Australia introduced a 7 per cent surcharge on 1 January 2018 and Western Australia a 7 per cent surcharge from 1 January 2019.

Figure 3

Victoria building approvals – Number (houses and apartments)



Source: Australian Bureau of Statistics

Based on above analysis, foreign investment appears to be highly sensitive and has a high price elasticity of demand. That is, for a given increase in tax paid (whether that be FPAD or AOS), there is a significant reduction in the amount of investment. This may also be driven by signalling by respective State Governments that investment is no longer welcome.

Based on above analysis, foreign investment appears to be highly sensitive and has a high price elasticity of demand. That is, for a given increase in tax paid (whether that be FPAD or AOS), there is a significant reduction in the amount of investment. This may also be driven by signalling by respective State Governments that investment is no longer welcome.

6.7 Independent confirmation that FPAD and AOS impacts foreign investment

According to Housing Australia (formerly National Housing Finance and Investment Corporation), a range of factors affect housing demand.

However, Housing Australia Industry liaison suggests that increases in Commonwealth and State Government fees for newly purchased residential dwellings has affected the level of demand from foreign investors in recent years. Based on NHFIC analysis, AEAS estimates that the impact of both the FPAD and the AOS are to increase the cost of building a $750,000 dwelling in Victoria by approximately 0.8 to 0.9 per cent.

Government policy settings on taxation (for example, State Government stamp duty or the Commonwealth tax treatment of rental income and capital gains) impact on decisions by owner-occupiers and investors.

Housing Australia

07 Economic and employment impacts of FPAD and AOS

Economic modelling of the contribution of the property industry to the Victoria economy (AEC, 2018) was used to estimate the contribution made by foreign residential investors.

7.1 Economic activity

The 2014-15 financial year represented the peak of foreign residential investment in Victoria. Foreign residential investment is estimated to have directly contributed between $2.8 billion (30 per cent conversions) and $4.7 billion (50 per cent conversions) in Gross State Product (GSP) to the Victorian economy in 2014-15. This activity, primarily driven through residential construction activity to meet foreign investor demand for new dwellings, also provided significant flow-on impacts throughout the Victorian economy. In total (including direct and flow-on activity), foreign residential investment is estimated to have contributed between $8.7 billion and $14.3 billion in GSP in 2014-15 (see table 3).

In 2015-16 and 2016-17, the number and value of dwellings purchased by foreigners declined considerably and across the period to 2023-24 is estimated to have reduced by 85.6 per cent. The subsequent economic contribution provided has also declined proportionately.

Applying the reduction in the level of investment approvals, the reduction in activity supported by foreign investors is estimated between $7.5 billion to $12.2 billion in 2023-24 compared to 2014-15 levels. Of this, $6.8 billion - $11.2 billion is attributed to FPAD and $700 million - $1.0 billion is attributed to AOS. Over the period 2015-16 to 2023-24, the net loss to the Victorian economy is estimated at between $57 and $93 billion.

Table 3

Economic contribution of foreign investors ($ millions)

30 per cent conversion

2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Direct contribution									
2,810.7	2,468.0	763.7	847.9	718.8	540.6	498.2	309.9	430.7	405.8
Flow on-contribution - production induced									
2,369.0	2,080.2	643.7	714.6	605.9	455.7	419.9	261.2	363.0	342.0
Flow on-contribution - consumption induced									
3,563.3	3,128.9	968.2	1,074.9	911.3	685.4	631.6	392.9	546.0	514.4
Total contribution									
8,743.0	7,677.0	2,375.6	2,637.4	2,236.0	1,681.7	1,549.8	964.1	1,339.7	1,262.2
50 per cent conversion									
Direct contribution									
4,702.3	4,128.9	1,277.7	1,418.5	1,202.6	904.5	833.5	518.5	720.5	678.8
Flow on-contribution - production induced									
3,804.2	3,340.4	1,033.7	1,147.6	972.9	731.7	674.3	419.5	582.9	549.2
Flow on-contribution - consumption induced									
5,767.3	5,064.1	1,567.1	1,739.8	1,475.0	1,109.3	1,022.3	635.9	$883.7	832.6
Total contribution									
14,273.8	12,533.4	3,878.4	4,305.8	3,650.5	2,745.6	2,530.2	1,573.9	2,187.1	2,060.6

Source: AEAS 2024

Table 4

Loss in economic contribution of foreign investors ($ millions) as a result of FPAD and AOS

30 per cent conversion

2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Direct contribution								
342.7	2,047.0	1,962.8	2,091.9	2,270.1	2,312.5	2,500.8	2,380.0	2,404.9
Flow on-contribution - production induced								
288.8	1,725.3	1,654.4	1,763.1	1,913.3	1,949.1	2,107.8	2,006.0	2,027.0
Flow on-contribution - consumption induced								
434.5	2,595.1	2,488.4	2,652.0	$2,877.9	2,931.7	3,170.4	3,017.3	3,048.9
Total contribution								
1,066.0	6,367.4	6,105.6	6,507.0	7,061.3	7,193.3	7,779.0	7,403.4	7,480.9
50 per cent conversion								
Direct contribution								
573.3	3,424.6	3,283.8	3,499.7	3,797.8	3,868.7	4,183.7	3,981.8	4,023.4
Flow on-contribution - production induced								
463.8	2,770.5	2,656.6	2,831.3	3,072.5	3,129.9	3,384.7	3,221.3	3,255.0
Flow on-contribution - consumption induced								
703.2	4,200.2	4,027.5	4,292.3	4,657.9	4,745.0	5,131.3	4,883.6	4,934.7
Total contribution								
1,740.3	10,395.3	9,967.9	10,623.3	11,528.2	11,743.6	12,699.8	12,086.7	12,213.2

Source: AEAS 2024

7.2 Employment

Foreign residential investment is also a significant contributor to employment and household incomes in Victoria. In 2014-15 it is estimated a total of between 64,743 and 106,296 jobs full time equivalent (FTE) jobs were supported by foreign residential investment (including direct and flow-on jobs).

As a result of the number and value of dwellings purchased by foreigners declining considerably, the employment contribution has also declined. Applying the reduction in the level of investment approvals, the reduction in employment supported by foreign investors is estimated between 55,397 and 90,951 jobs in 2023-24 compared to 2014-15 levels. Of these, 50,577 – 83,038 lost jobs are attributed to FPAD and 4,820 – 7,913 lost jobs are attributed to AOS).

Table 5

Employment contribution of foreign investors (persons)

30 per cent conversion

2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Direct contribution									
2,810.7	2,468.0	763.7	847.9	718.8	540.6	498.2	309.9	430.7	405.8
Flow on-contribution - production induced									
2,369.0	2,080.2	643.7	714.6	605.9	455.7	$419.9	$261.2	$363.0	342.0
Flow on-contribution - consumption induced									
3,563.3	3,128.9	968.2	1,074.9	911.3	685.4	631.6	392.9	546.0	514.4
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50 per cent conversion									
Direct contribution									
4,702.3	4,128.9	1,277.7	1,418.5	1,202.6	904.5	833.5	518.5	720.5	678.8
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3,804.2	3,340.4	1,033.7	1,147.6	972.9	731.7	674.3	$419.5	582.9	549.2
Flow on-contribution - consumption induced									
5,767.3	5,064.1	1,567.1	1,739.8	1,475.0	1,109.3	1,022.3	635.9	883.7	832.6
Total contribution									
14,273.8	12,533.4	3,878.4	4,305.8	3,650.5	2,745.6	2,530.2	1,573.9	2,187.1	2,060.6

Source: AEAS 2024

Table 6

Loss in employment contribution of foreign investors (persons) as a result of FPAD and AOS

30 per cent conversion

2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Direct contribution									
2,810.7	2,468.0	763.7	847.9	718.8	540.6	498.2	309.9	430.7	405.8
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Total contribution									
14,273.8	12,533.4	3,878.4	4,305.8	3,650.5	2,745.6	2,530.2	1,573.9	2,187.1	2,060.6

Source: AEAS 2024

08 Commercial real estate

The impact of FPAD and AOS on foreign investment in Victorian commercial real estate is equally negative. AEAS sourced FIRB approved proposals for foreign investment in Victorian commercial real estate from FIRB annual reports.

Analysis of commercial real estate is unfortunately limited due to the volatile nature of the data with very large commercial transactions and the discontinuation of this data set in 2020-21. Nevertheless the trend line removing the 2020-21 year result indicates an established and significant reduction in foreign investment in Victorian commercial real estate.

Over the period 2013-14 to 2019-20 (removing 2017-18) there has been an average loss of foreign investment each year of $1.468 billion. The average value of the foreign investment per approval over this period is $49 million and compares to the average foreign investment for each residential real estate approval of $885,200. This highlights the high importance of foreign investment in commercial real estate as it has a significantly higher worth and is equally sensitive to FPAD and AOS.

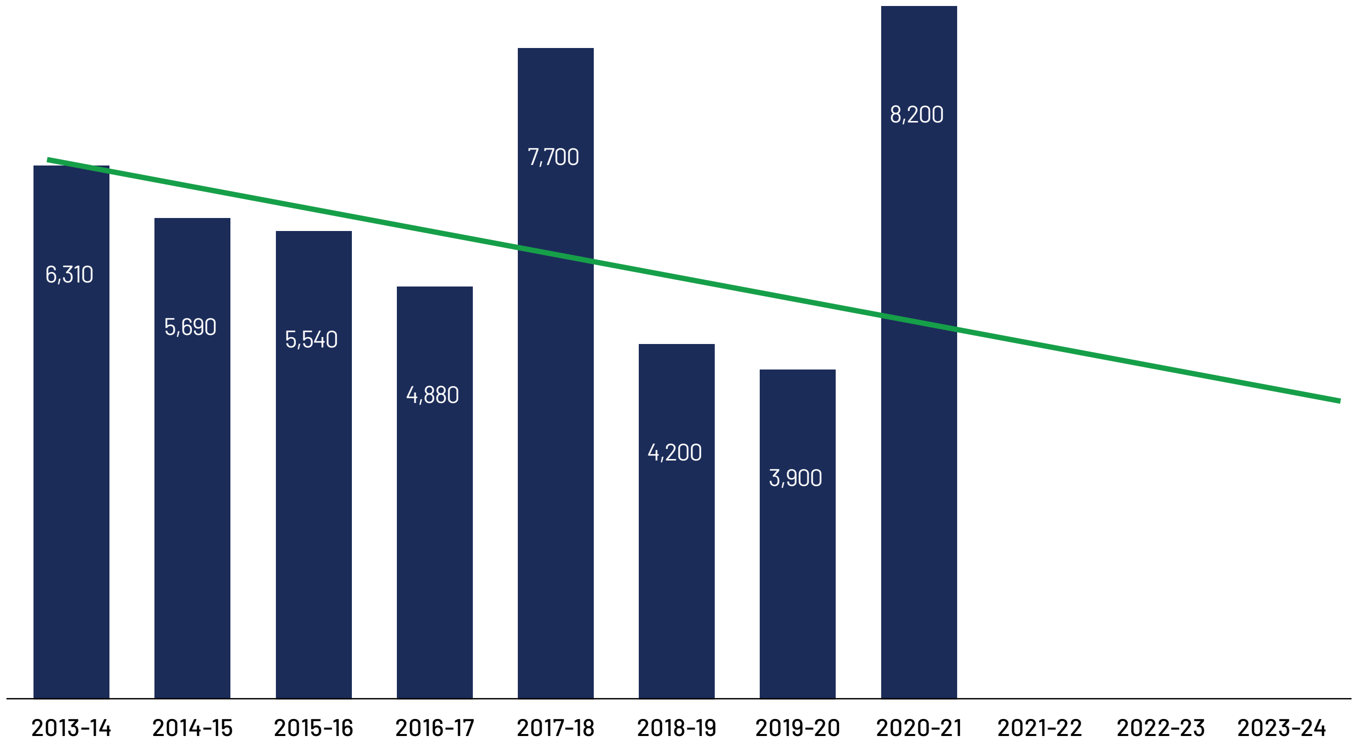
Table 7

Loss of foreign investment estimates 2013-14 to 2019-20 ($ billion)

Average loss of foreign investment each year	1.468
Total loss of foreign investment	7.340

Source: AEAS 2024

Figure 4
Loss in foreign investor commercial real estate in Victoria ($ millions)



Source: AEAS 2024

AEAS recommends that Commonwealth Treasury recommence reporting the number and value of foreign investment approvals in commercial real estate by State.

09 Economic and fiscal interpretation of results

9.1 Economic impact of FPAD and AOS

Retaining the surcharge provides considerable risk of further disincentivising foreign investment in Victoria's residential and commercial property markets, thereby reducing the contribution of these investors to economic activity in Victoria.

Taxing foreign investment in real estate is clearly shown to have given rise to the following suboptimal outcomes:

01 **Reduced rental stock:** The stock of new houses and apartments that were previously bought on line were significantly used in the rental market by Victorian residents and the subsequent collapse in foreign investment approvals has commensurately led to a collapse in new rental stock that was previously used to assist in filling the housing shortages and addressing home affordability across the State.

02 **Reduced foreign investment:** Victoria's high taxes on foreign investment has deterred international investors from putting money into the local real estate market as a result of reduced return on investment. This has led to decreased capital inflows and slower economic growth in the sector as a result of both FPAD and AOS.

03 **Economic impact:** Previously foreign investment in Victorian real estate contributed significantly to economic activity, job creation, and infrastructure development. As an example international property developers have acted a major employers. However taxing such investments has unquestionably reduced these positive economic impacts. Increasing the surcharge on foreign investors has increased the overall cost to these investors and in turn decreased Victoria's attractiveness for foreign investors.

04 **Competitiveness:** Victoria is in competition with other States for property investment and when coupled with a range of other uniquely regressive taxes, PFAD and AOS are likely to be placing Victoria at a competitive disadvantage.

05 **Market stability:** Foreign investors have previously provided liquidity and stability to the Victoria real estate market by diversifying risk and increasing market depth. However taxing this foreign investment through FPAD and AOS has reduced this stability and exacerbated volatility.

06 **Complexity and administration:** Taxing foreign investment has also introduced complexity into the State's tax system that requires additional administrative resources to monitor compliance and enforce regulations.

07 **Sovereign risk and openness:** Victoria is now known for imposing high taxes on foreign investment and is perceived as less open to international business and investment opportunities. This has undoubtedly impacted on the State's global competitiveness.

Table 8
PFAD and AOS rates by state (%)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
PFAD	8.0	8.0	7.0	0.0	7.0	8.0	0.0	0.0
AOS	4.0	4.0	2.0	0.0	0.0	2.0	0.0	0.75

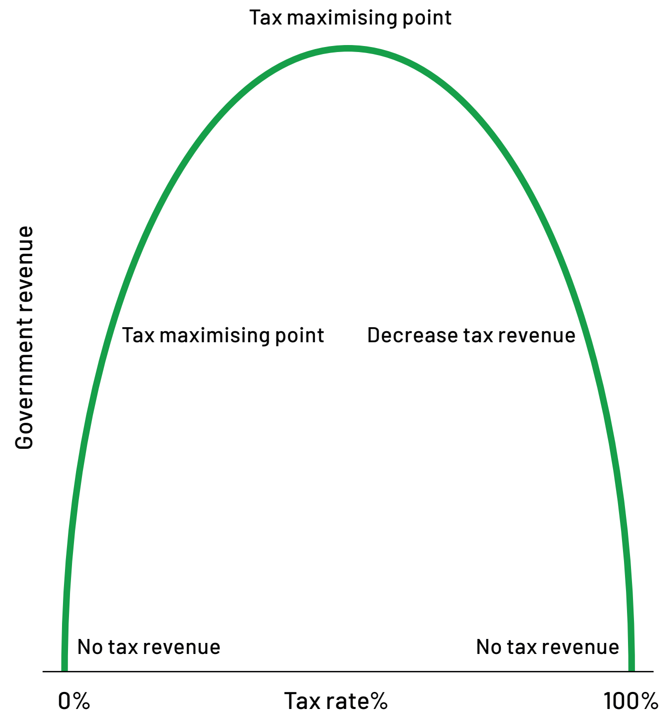
Source: Interstate comparison of taxes 2023-24, NSW Treasury

9.2 Suboptimal taxation policy

One of the issues relating to assessment of Victoria's FPAD and AOS is the lack of transparency around the revenue raised. Based on the extent of the reduction in foreign investment, FPAD and AOS is estimated to have reduced the overall revenue the Victorian Government receives in property taxes.

In economics the Laffer Curve illustrates the relationship between tax rates and tax revenue, suggesting that there is an optimal tax rate that maximises revenue (beyond which higher rates may reduce revenue).

Figure 5
Laffer curve and how it relates to FPAD and AOS



Source: AEAS 2024

The Laffer curve indicates that in most circumstances, a reduction in tax rates will actually increase government revenue and not necessarily need to be offset by decreased government spending or increased borrowing. The vice versa also holds. An explanation of figure includes:

- A tax rate of zero will result in zero government revenue;
- A tax rate of 10 per cent will also result in zero government revenue;
- As the tax rate increases from zero, there is an increase in the revenues to government;
- As the tax rate continues to increase, the resultant increase in government revenue begins to slow; and
- At a particular point the curve peaks and revenue is progressively lost.

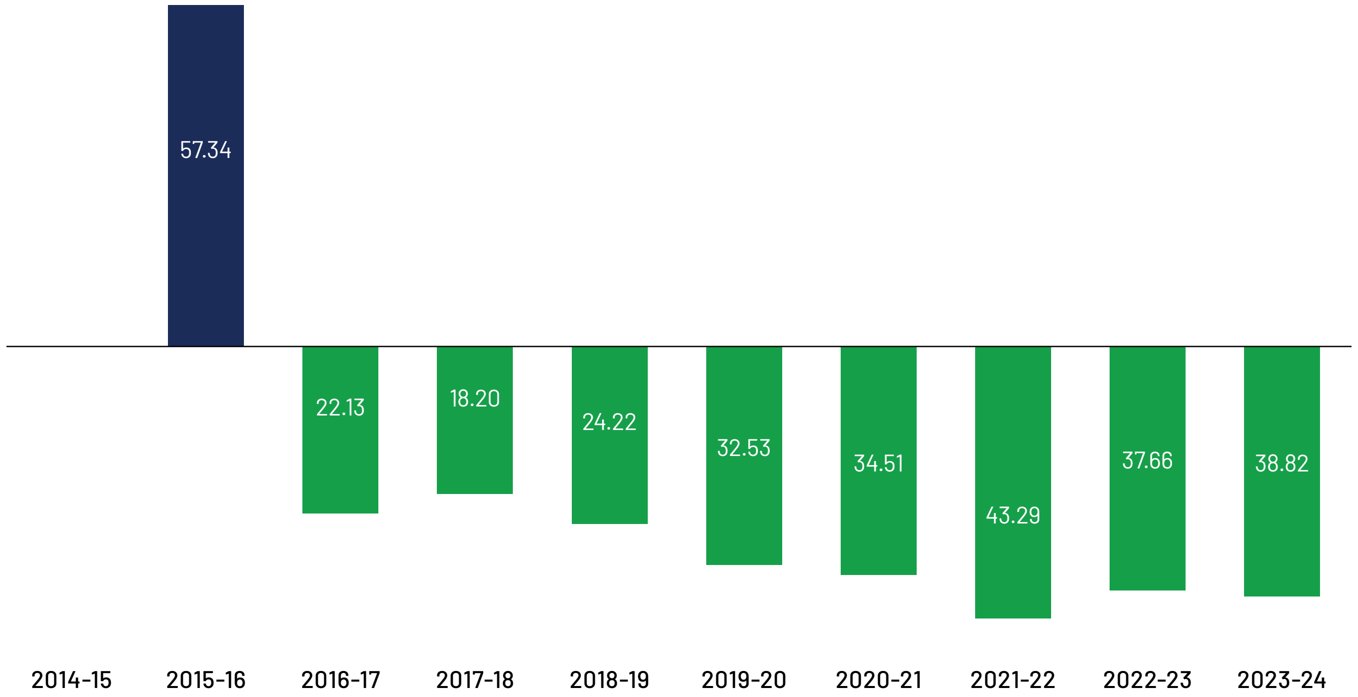
Changes in tax rates impact on government revenues in two ways. The first one is immediate, which Laffer describes as "arithmetic." Every dollar in tax cuts translates directly to one less dollar in government revenue. The other effect is longer-term, which Laffer describes as the "economic" effect. It works in the opposite direction. Lower tax rates put money into the hands of taxpayers, who then spend it. It creates more business activity, for example companies may hire more workers who in turn spend their additional income.

Businesses may alternatively invest in their own business raising GST revenue. Both boost economic growth and generate a larger tax base. It eventually replaces any revenue lost from the original tax cut.

In summary the 'economic' effect of the tax cut will outweigh the 'arithmetic' effect as described by Laffer in the longer term.

It is difficult to calculate the tipping point where tax falls away on the Laffer Curve. However based on the extraordinary decrease in foreign investment in Victoria residential property, Victoria is clearly on the right hand side of the Laffer Curve. Furthermore, FPAD is considered to have very high elasticity meaning small changes in tax rates significantly affect foreign investor incentives to earn income and investment in Victoria. As indicated in section 6 and 8, foreign investment is considered to be highly elastic given the level of decrease in investment.

Figure 6
Estimated net tax losses to the Victorian budget ($ millions)



Source: AEAS 2024

Based on a dramatic reduction in foreign owned property transactions each year and the loss of normal stamp duty and land tax that they otherwise would have paid, over the period 2015-16 to 2023-24 the Victorian Budget is estimated to be worse off by a net $194 million as a result of PFAD and AOS compared against the counterfactual base of no foreign property taxes being introduced. In 2023-24, the Victorian Budget is worse off by a net $38.8 million as a result of FPAD and AOS compared against the counterfactual base of no foreign property taxes being introduced.

In summary, the Victorian Government has taxed foreign investors to the point whereby the tax revenue they are contributing under FPAD and AOS have fallen and will continue to fall. Not only has FPAD and AOS been lost due to the collapse in foreign investment but general transfer duty and land tax have as well. When considered across all the above taxes in aggregation the concept of the Laffer Curve becomes even more pronounced.

Given there are considerable advantages of foreign investment in Victorian residential and commercial property, negative impacts have previously been debunked by the RBA and others, tax revenue raised is now believed to be minimal or potentially negative as it has collapsed foreign investment the question has to be asked about why the Victorian Government is pursuing this suboptimal policy through the FPAD and AOS.

Appendix A
AEAS business information

Australian Economic Advisory Services delivers services in economic analysis, research and advocacy in Australia and was set up by Nick Behrens following two decades of experience applying these skills in the real world for Australia's business community. More specifically AEAS provides:

- Economic Contribution and Valuation Analysis;
- Data Analysis, Market research and Economic Modelling;
- Stakeholder Consultation; and
- Government Relations and Submissions.

AEAS delivers services nationally to exemplary organisations including Australian Industry Group, Australian Gas Industry Trust, BASF, Brisbane Airport Corporation, CCIQ, Canegrowers, IOR Pty Ltd, LifeFlight, Maleny Dairies, Master Builders Australia, Natroads, Port of Brisbane, Property Council of Australia, Victoria Resources Council, RACQ, Remondis, Suncorp, VTA, Victorian Waste Management Association, unions, local government authorities, the Commonwealth and State Governments and many others.

We can be engaged for either a special project (for the entire project or just the parts our clients need help with) or on an ongoing basis. We will take the time to understand your unique challenge and create a partnership with you to tailor a solution specific to your budget. We engage with confidentiality and integrity. Choose AEAS for our expertise, professionalism and ability to work with our valued clients to achieve exceptional results.

Report author: Nick Behrens

Across his professional career Nick has realised many outstanding outcomes to complex challenges for the business community. He possesses significant experience in gathering and presenting information, and leveraging that information to achieve results across a range of areas including economic, taxation, regulatory environment, workers compensation, employment legislation, population, infrastructure and planning issues. As Director of Victoria Economic Advocacy Solutions (AEAS), Nick provides:

- Exceptional understanding of social, political and economic issues impacting on business and the economy;
- Considerable real-world application of project, business and economic research and analysis;
- Significant expertise in advocacy, including government and stakeholder relations;
- In-depth and firsthand knowledge of the workings of Government;
- Extensive networks in political, government, business and community sectors;
- Previous appointments on a number of high level Government committees; and
- Media commentator and public speaker.

Nick's representations are based on extensive research and his preferred approach to economic analysis, research and advocacy is to achieve results by working with stakeholders behind the scenes to secure positive and lasting outcomes.

He places much emphasis on having a thorough and convincing evidence that is readily understood and in turn leads to real world application and solutions.

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Report preparation

This report has been prepared by AEAS for Property Council of Australia (Victoria Division).

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