Christopher Kent: Foreign investment in residential real estate

Opening statement by Mr Christopher Kent, Assistant Governor (Economic) of the Reserve Bank of Australia, and Mr David Orsmond, Deputy Head of Economic Analysis of the Reserve Bank of Australia, to House of Representatives Standing Committee on Economics Inquiry into Foreign Investment in Residential Real Estate, Sydney, 27 June 2014.

Thank you, Chair, for the opportunity to discuss this topic with you today.

As summarised in our Submission, foreign residential investment has been a feature of Australia’s housing sector for many decades. Foreign demand for housing has supported the local construction industry, while foreign-based developers provide access to alternative sources of financing and add a degree of competition to the sector. Some recent housing purchases have also been associated with the increase in the number of families, particularly from Asia, that want to educate their children in Australia. More broadly, foreign residential demand in Australia is linked to the rise in income and wealth globally, but particularly in Asia, which is adding to business opportunities as our economy becomes more integrated with others in the region. This is welcome and to be expected.

An underlying theme in much of the commentary has been whether foreign residential investment has increased the demand for Australian housing by more than it has increased supply, and hence whether it has led to an increase in housing prices, especially for first home buyers.

The data clearly show an increase in the level of approvals for foreign residential purchases over time, but it is difficult to know how much this has boosted net demand for Australian housing. While varying a bit from year to year, the data published by the Foreign Investment Review Board (FIRB) suggest that foreign purchase approvals have been fairly low as a share of national housing turnover. Specifically, the FIRB data suggest that the value of foreign residential approvals has generally been around 5–10 per cent of the value of national housing turnover. Using several assumptions, we estimate that the number of foreign approvals has been around half of that range. In its Submission to this Committee, FIRB included data covering the first three quarters of this financial year, which show a rise in approvals, especially for new dwellings. Nonetheless, it is important to remember that the share of actual residential purchases by foreign and temporary residents is likely to be much lower than the FIRB data suggest because not all approvals lead to a purchase. This point is outlined in our Submission and in a recent article published in the Bank’s Bulletin.

It is worth emphasising that the purchase of a property by a foreign citizen or temporary resident may not contribute one for one to net housing demand in Australia. For instance, there would be little effect on net demand if the property purchased is used to house foreign students who would otherwise have needed to rent during their stay here. Similarly, net demand for housing would be little changed if an investment property is subsequently rented out. There is no comprehensive information on the magnitude of these types of transactions. So, while it seems likely that foreign residential purchases have added somewhat to net housing demand in Australia, there is no way of knowing the exact extent to which this has been the case.

Whether an increase in net housing demand – be it from foreign or domestic sources – leads to higher housing prices depends on the responsiveness of supply. This subject has been

---

especially topical of late, with housing prices nationally rising by close to 10 per cent over the past year. The rise in prices has primarily reflected increased housing demand from Australian residents and citizens, partly owing to low interest rates. The supply of housing is responsive to a rise in housing demand but, given the time needed to plan and build new housing, this typically occurs with some lag. However, several factors can accentuate this lag, including:

- a shortage of well-located land and geographical constraints in our capital cities
- the complexity of the planning and approval process, which adds to the time and costs of new housing developments
- concerns of existing residents in regard to new development projects in their vicinity.

These are not easy issues to address, although it is widely agreed that an appropriate balance needs to be struck if housing is to be provided at a reasonable cost. Through the Bank’s business liaison, we hear from housing market participants that impediments to increasing the supply of housing in some greenfield areas have eased in recent years. Also, there has been interest in converting some of the older office buildings in central business districts into residential use, which may ease the shortage of land in highly sought after areas. However, our contacts also report that more could be done to increase the responsiveness of housing supply to demand.

Notwithstanding general concerns about the responsiveness of supply, the information available suggests that foreign residential purchases have probably not had a large direct effect on the price of housing that is typically purchased by first home buyers. While incomplete, the FIRB data and the information received through our liaison with developers suggest that most foreign residential purchases are for new, higher-density, inner-city properties as well as properties close to universities. Furthermore, the properties they purchase tend to be valued well above the average national sales price. In contrast, most purchases by first home buyers have been for established homes that are priced well below the national average. Moreover, when they do purchase new housing, first home buyers appear to generally purchase detached homes close to the fringe of the main cities rather than new apartments located close to the city centres. Of course, there are some foreign buyers that purchase cheaper homes outside the inner-city areas, just as there are some first home buyers that purchase inner-city properties priced above the national average. But in the main, foreign buyers appear to be purchasing properties that are typically quite different in their characteristics from those purchased by most first home buyers.

Finally, I would like to comment on the issue of the availability of data. FIRB’s main role is to ensure foreign purchases are consistent with the rules, rather than to provide data on the actual level of foreign investment. Even so, a case could be made for more timely provision of the approvals data that are already collected by FIRB, perhaps publishing them on a quarterly rather than annual basis. Also, more granular data could be provided, such as the number of approvals within broad price brackets rather than just the total value and number of approvals. Beyond that, the benefits of any new reporting requirements in this area should be weighed carefully against the costs of its collection and administration.

With those introductory comments, my colleague, Dr David Orsmond, and I are happy to take any questions you may have.