This chapter discusses the changing foreign investment landscape in Australia, and the accomplishments and challenges faced by the Board in 2017–18. It outlines:

- changes to the foreign investment landscape, including to critical infrastructure regulation;
- key areas of policy focus and changes to the foreign investment framework in 2017–18; and
- the redesign of the FIRB Application Portal.

Foreign investment policies and priorities

Foreign investment helps develop domestic assets, introduces technical and management expertise, and assists Australian businesses to expand into overseas markets.[3] Australia's large, resource-rich land mass, proximity to fast-growing markets, easy access to finance and strong rule of law, make it an attractive investment destination.

3 For information on the economic activity of foreign owned businesses in Australia see Australian Bureau of Statistics (ABS) Catalogue no. 5494.0 – *Economic Activity of Foreign Owned Businesses in Australia, 2014-15*.
Breakdowns by source country and Australian industry factsheets are available from the Department of Foreign Affairs and Trade (DFAT) website.

Net inward flows of foreign direct investment to Australia averaged around $51 billion a year over the five years to 2017, ranging from $27.2 billion in 2015 to $64.2 billion in 2016.[4]

The Australian Government maintains an open and non-discriminatory foreign investment framework that balances encouraging foreign investment flows while ensuring foreign investment is not contrary to the national interest.

The framework is designed to ensure that foreign investment is appropriately assessed, and assures the Australian public that national interest factors are properly considered. This Government, like previous Australian Governments, supports a case-by-case approach to considering foreign investment proposals. Under the *Foreign Acquisitions and Takeovers Act 1975*, the Treasurer can reject proposals found to be contrary to the national interest, or can impose conditions on an investment to address national interest concerns.

4 ABS, Catalogue no. 5352.0 – *International Investment Position, Australia: Supplementary Statistics*. Foreign Direct Investment (FDI) is related to when a foreign entity makes an investment that gives control or a significant degree of influence on the management of an enterprise. It tends to be associated with a lasting relationship. For the statistical definition of direct investment, see Chapter 6 of the IMF's *Balance of Payments and International Investment Position Manual (BPM6)*.

Arrium case study

In 2017, GFG Alliance, led by British businessman Mr Sanjeev Gupta, acquired Arrium's steel and mining business. The acquisition included the Whyalla Steelworks, associated iron ore mines, the Port of Whyalla and the associated steel manufacturing, recycling and distribution businesses.

Arrium had been in voluntary administration for over 12 months with $4 billion in debt. The acquisition effectively saved 5,500 jobs and the viability of Whyalla.

The Board reviewed the acquisition to ensure that it was not contrary to the national interest. This particularly took into account the location and nature of the assets, and the impact on employees and the community.

Mr Gupta's plans included more than $1.35 billion in new investment with a significant emphasis on renewable energy projects to help reduce the steelworks' operating costs. There are plans for pumped hydroelectric storage and an upgrade to the co-generation plant, with the major investment the construction of the 280 megawatt Cultana Solar Farm Project.

The Cultana Solar Farm Project is to be developed in 2019. It is expected to generate enough electricity for 96,000 homes, employ 350 workers during construction, and ensure greater energy security for the steelworks. Mr Gupta has also announced plans to construct the world's largest lithium-ion battery in South Australia, creating a further 100 jobs during construction.

Whyalla Mayor Lyn Breuer was reported as saying the acquisition by Mr Gupta was a huge relief for the regional town of 22,000 people. It had lifted the cloud from over Whyalla, ending 15 months of uncertainly, during which time people had stopped spending and businesses had gone under. The Mayor said that the proposed transformation of the steelworks would transform not only the company's operations, but also the entire community. The company's vision for the region had the community's full support.

The changing foreign investment landscape

Despite solid global economic growth, the backdrop for foreign investment in Australia and globally has become more challenging in recent years. In particular, heightened geo-political uncertainty and international trade tensions have resulted in foreign investors becoming increasingly selective about their investment decisions and destinations. Chinese outbound investment to Australia and the rest of the world has also slowed as authorities have tightened capital controls.

While Australia's resources sector, which has traditionally been attractive for foreign investment, continues to receive investor interest, the services sector is now receiving greater attention. This is particularly true of health care, which experienced a $3.7 billion year-on-year increase of approved foreign investment. As foreign investors from developing economies seek to meet growing middle class consumption demands, and investors globally look to acquire advanced technology and best-practice management techniques, as well as expand their global market presence, this trend towards foreign investment in Australia's service sector is expected to continue.[5]

In 2017-18, the Board continued to manage a range of complexities associated with large commercial investments in sectors critical to the Australian community and economy. The past two reporting periods saw increased complexity associated with privatisation of large state-owned electricity assets and sales of data centres combined with a heightened national security environment – in particular the security of critical infrastructure and nationally important data. While there continues to be significant foreign interest in critical infrastructure assets and data centres, 2017-18 saw growing interest in the sale of large health and financial services businesses. As with sales of data centres, these types of acquisitions raise national interest factors associated with the protection of sensitive data. Consequently, the development of data security conditions continued to be a key area of focus for the Board, to ensure a change of ownership does not present an unmanaged risk of unauthorised access to personal, government, or sensitive operational data.

The imposition of conditions on approvals continued to play an important role in enabling foreign investment to proceed while safeguarding the national interest and managing any identified risks.

Key developments in 2017–18

In the reporting period, key areas of policy focus for the Board related to implementing the regulatory changes introduced in the 2017-18 Budget, including streamlining measures and the introduction of a vacancy fee in respect of residential real estate, and policy announcements concerning the acquisition of agricultural land and electricity assets. The Board and FIRB agencies supported the establishment of the Critical Infrastructure Centre

5 For more detail please see the 'Foreign Investment Outlook' box at page 22.

(CIC) and the Australian National Audit Office's (ANAO) review and report, *Management of compliance with foreign investment obligations for residential real estate.*

Implementation of the 2017–18 Budget reforms

In 2017-18, FIRB agencies supported the implementation of a range of reforms announced by the Government in the previous reporting period, including a number of streamlining measures that came into effect on 1 July 2017.

These streamlining measures have reduced the requirement for investors to seek multiple approvals for similar low risk transactions by:

- allowing developers to re-sell to foreign persons 'as new' off-the-plan dwellings that failed to settle, and therefore may be considered 'established';
- introducing an exemption certificate so that only one approval is required for individuals considering a number of residential properties with the intention to purchase only one;
- changing fees to improve transparency and consistency, reduce complexity and achieve more equitable fee outcomes across different categories of transactions; and
- introducing a new business exemption certificate for interests in assets and securities to enable broad pre-approval for routine transactions.

Treasury worked closely with consult agencies, applicants and their advisers over the past 12 months to implement these changes, particularly processes to support business exemption certificates.

Business exemption certificates

Business exemption certificates were introduced on 1 July 2017, to provide a streamlined process for routine, low sensitivity transactions. They minimise the regulatory cost of the foreign investment framework on investments of relatively low value and sensitivity.

Rather than having to notify prior to each separate acquisition, a business exemption certificate allows a foreign person to apply only once for pre-approval for multiple acquisitions of assets or securities over a specified period and up to a specified monetary limit. The certificates are suited to large investment funds, particularly those with low risk foreign government investors. For these funds, the exemption certificates reduce the regulatory cost that would have been associated if separate applications were required for multiple acquisitions. The certificate also suits investors who may not have exact target acquisitions in mind when they seek approval, but intend to make a series of passive investments in sectors or industries that typically do not raise national interest concerns.

The certificates are available in addition to existing exemption certificates for the acquisition of land and land entities, and mining and exploration tenements.

The Australian National Audit Office (ANAO) report on residential real estate compliance

In 2017-18, FIRB agencies supported the ANAO review and report *Management of compliance with foreign investment obligations for residential real estate,* which was tabled in parliament in June 2018.

The report presents a comprehensive review of the arrangements the Government implemented in December 2015 to strengthen compliance with residential real estate rules. This included the transfer of administrative responsibility for residential real estate from Treasury to the ATO along with additional enforcement powers. The ANAO report is largely positive about the arrangements implemented, finding that overall, ATO processes for investigating compliance with the residential real estate rules are effective. It noted the significant work undertaken by the ATO to develop processes and systems to support the detection and investigation of non-compliance with foreign investment obligations for residential real estate.

The report made practical recommendations to improve the ATO’s effectiveness in detecting non-compliance and reporting. The ATO has already commenced work to implement these recommendations, including compiling an overarching compliance and enforcement strategy, and implementing outstanding data matching rules to aid the detection of key compliance risks.

The report contained no specific recommendations for Treasury but the ANAO did observe that the public guidance material could be simplified to ease navigation. Treasury is in the process of reviewing and updating its guidance material and the FIRB website.

Implementation of the residential real estate vacancy fee

In the 2017–18 Budget, the Government introduced enhanced rules for foreign investors to ensure that more homes are available for Australians by introducing a vacancy charge for houses left vacant for more than six months. Foreign persons who purchased a dwelling after 9 May 2017 are required to lodge an annual vacancy fee return. If the dwelling has not been genuinely occupied as a residence or available for rent for at least 183 days in the previous 12 months foreign persons will have to pay a vacancy fee.

The ATO administers the vacancy fee and uses its extensive data matching capability against a variety of sources, together with community information to monitor compliance. In June 2018, a new online vacancy fee return, along with guidance material and a pre-recorded webinar were published on the ATO's website. To support implementation of the new requirement, the ATO has a comprehensive communications strategy in place and has engaged extensively with foreign persons and their advisers to raise awareness of the fee, including conducting:

- face-to-face visits with over 20 foreign investment advisers (each representing more than 100 applicants); and
- live webinars, targeted at foreign investment advisers through the tax practitioner community, and lawyers and conveyancers through industry associations.

Policy announcements in 2017–18

Australian electricity assets

On 1 February 2018, then Treasurer, the Hon Scott Morrison MP, issued a media release announcing that all future sales of electricity transmission, distribution and generation assets would attract ownership restrictions or conditions for foreign buyers.

The announcement recognised the important role played by critical electricity infrastructure in underpinning a range of services to the community. In some cases, aggregated ownership of critical infrastructure may increase risks to national security and maintaining diversity of ownership at the company and country level operates as an important national security safeguard.

The announcement formalised the approach already being applied at the time when assessing the national interest on a case-by-case basis. It provided a clear signal that existing levels of foreign ownership in an asset, within a sector or subsector are considered when assessing foreign investment applications. The announcement responded to requests for greater clarity around the types of factors taken into account when assessing foreign investment applications in this sector.

Agricultural land sale processes

On 1 February 2018, the Treasurer also issued a media release clarifying the importance of an open and transparent sale process when assessing applications for acquisitions of agricultural land.

The Government recognises that investment in agriculture is important for growth and innovation and contributes to the prosperity of local businesses, rural communities and the broader economy. However, it is essential that the right checks and balances are in place to ensure that foreign investment is not contrary to the national interest, including that Australians are provided with the opportunity to bid for agricultural land.

Concerns around the ability of Australians to participate in sales processes for agricultural land acquisitions were a factor in previous foreign investment decisions, including the 9 December 2016 approval for the acquisition of S. Kidman & Co Limited. Again, the announcement provided greater clarity to foreign investors wishing to purchase agricultural land that the sales process is an important factor when assessing whether a proposed acquisition is in the national interest.

Treasury engaged a range of stakeholders following the announcement to raise awareness of the requirement and develop practical guidance to support implementation of the policy. In September 2018, in response to stakeholder feedback, the foreign investment framework's online guidance notes were updated and clarified to ensure the requirement is appropriately targeted.

Managing national security risks to critical infrastructure

In the 2017–18 reporting period, the Board and the Treasury continued to address risks to critical infrastructure in a comprehensive and proactive manner. Treasury maintained a key role in the implementation of the newly established CIC and passage of the *Security of Critical Infrastructure Act 2018* (SOCI Act).[6]

The CIC, now within the Department of Home Affairs, was established in February 2017 to support a more comprehensive approach to manage national security risks to critical infrastructure that can arise through foreign investment and supply chain arrangements. In the reporting period, Treasury participated in a range of stakeholder consultations on the role of the CIC, particularly with respect to the CIC's role as a source of expert advice to the Board and the Treasurer for foreign investment transactions, and the development of the SOCI Act.

The SOCI Act came into force on 11 July 2018, and provides information-gathering powers to the CIC, a ministerial directions power, and establishes a register of critical infrastructure

6 More information is available on the Department of Home Affairs website under 'Security of Critical Infrastructure Act 2018'.

assets in Australia's highest risk sectors (water, ports, electricity and gas). The SOCI Act applies to domestic and foreign owned assets.

The SOCI Act complements separate legislation that came into force on 18 September 2018 to manage national security risks to the telecommunications sector, the highest risk critical infrastructure sector.[7] The SOCI Act, telecommunications sector security reform legislation and the foreign investment framework provide the Government with a framework to manage national security risks that may arise from foreign involvement in Australia's highest risk critical infrastructure sectors.

Over time, the work of the CIC to identify and manage risks to critical infrastructure will provide a more proactive approach to manage key risks, including those that require management through any future foreign investment review process.

The FIRB Application Portal

The FIRB Application Portal is the main channel through which foreign investors apply to invest in Australia. In 2017–18, in response to stakeholders' feedback, the Portal was redesigned to deliver a more flexible, user-friendly experience. The redesign removed a number of barriers to make it easier for foreign investors to submit applications. Improved functionality was delivered through an enhanced fee calculator, the ability to lodge one application for multiple notifiable actions, and the ability to lodge a variation application for an earlier approval or exemption certificate.

To support foreign investors' transition to the Portal, a comprehensive communication strategy was implemented. This ensured that foreign investors were not only aware of the system enhancements, but were given an opportunity to test their understanding of the system before it 'went live' on 2 July 2018 and provide input into its development.

7 The Hon Peter Dutton (Minister for Home Affairs), *Telecommunications sector security reforms come into force,* media release, Parliament House, Canberra, 18 September 2018.

The Chinese investment in Australia (CHIIA) database

The CHIIA database, a database maintained by the Australian National University, collects information on mainland Chinese direct commercial investment in Australia and covers foreign direct investment in Australia that is undertaken, controlled or effectively controlled by mainland Chinese investors.[8] It includes individual commercial transactions of all sizes by the date the investment is completed rather than when it is proposed or an agreement is entered into.

CHIIA contains data based on ultimate control or beneficial ownership rather than data on the country the money came from before entering Australia. This is important as the immediate source of the investment does not necessarily reflect ultimate control or ownership of the investment.

Some key findings from the CHIIA database include the following:

- Mainland Chinese investment is concentrated in particular sectors. For instance, mining accounted for a quarter of the total Chinese investment in the four year period 2014 to 2017.
- Mining, and rental, hiring and real estate services, and transport, postal and warehousing are the three sectors which received the largest share of Chinese investment during 2014 to 2017.
- There is considerable variability of investment by sector. For example, the transport, postal and warehousing sector was in the top three sectors for each year, except for 2017 when there was no investment in that sector.
- Over the four year period less than 20 per cent of transactions involved state-owned investors. However, by value of investment they accounted for around 47 per cent of all investment over the period.

8 The CHIIA database is available online on the CHIIA website.

Foreign investment outlook

In addition to screening foreign investment applications and administering the foreign investment framework, the Board and FIRB agencies also monitor the foreign investment landscape including by engaging with market participants. Engagement with stakeholders suggests that the finance and insurance sector, and the health sector, are expected to experience significant activity over the next 12 to 24 months. Globally, health sector mergers and acquisitions have experienced significant activity with nearly US$306 billion of deals announced through the first half of 2018. Industry contacts suggest that aged care, radiology, and supplements are anticipated areas of interest in the Australian market.

Australia has experienced a recent rebalancing of net inflow of foreign direct investment away from mining and into non-mining sectors such as infrastructure and construction. This has been supported by elevated infrastructure spending across the country. Though state governments' privatisation programs have moderated, investor interest in state government assets continues.

In addition to the sectors noted by market participants, foreign investment applications for the second half of 2018 suggest that the mining, transport and infrastructure, utilities, and media sectors are also likely to experience strong activity over 2018–19 and beyond.

While the global investment environment is subject to change and uncertainty, there are significant opportunities for Australia from traditional sources of Foreign Direct Investment (FDI) including the United States and the United Kingdom, and from new sources such as China or Malaysia. Global FDI fell sharply in the first half of 2018 following the US tax reforms, although announced greenfield investments – an indicator of future growth – increased relative to the same period last year.

FDI inflows from China to Australia have moderated recently, which partly reflects China's continuing use of capital controls. We expect continued interest from the United States, the United Kingdom and China in advanced technology, health care and agriculture, but a softening of Chinese investment in real estate.