

## REGULATORY IMPACT STATEMENT – PROPOSED INCREASES TO THE OVERSEAS INVESTMENT FEES

### Executive Summary

The complexity of assessing overseas investment applications has consistently exceeded that expected when the overseas investment fees were set in 2005 upon the last reform of the overseas investment legislation. Fee revenue has not been sufficient to fund the operation of the Overseas Investment Office (OIO) and has led to delays in assessing applications. Based on current fees the OIO already has a memorandum account deficit and is expected to incur a further deficit of \$1.2 million in 2009/10. The deficit has been caused by three factors:

- **Higher prices (costs)** required to correct significant cost under-estimations since 2005. In the absence of operational experience, the OIO's costs were underestimated when it was formed in 2005 and have since been subsidised from other areas in LINZ.
- **Lower quantity.** In the last quarter of 2008, the number of applications received by the OIO fell by 25%, coinciding with the global economic recession. Fewer application numbers mean that fee revenue is lower and does not cover the OIO's costs.
- **Improved standards.** Personnel costs have increased as the OIO has increased staff numbers from five to twelve since 2005/06 in order to improve standards by significantly reducing application assessment times which benefits investors.

There are three options to offset this deficit:

- **Option A - Fully recover costs from investors.** This option will require a weighted average fee increase of 178%, with fee increases of between \$5,500 and \$13,300 per application.
- **Option B - Partially recover costs from investors.** This option will result in a weighted average fee increase of 120% with fee increases of between \$1,700 and \$8,400 per application. This option would not offset the fall in revenue caused by lower application numbers and is therefore expected to result in a deficit of around \$0.7 million in 2009/10.
- **Option C - Defer increase until the review of the screening regime is completed.** Any future changes to the screening regime are likely to require a reassessment of fees. However it is likely to be June 2010 before we are able to accurately assess the impact of any changes. Deferring a fee increase until this time is forecast to create a deficit of \$1.2 million.

Consultation with law firms who represent overseas investors has suggested that the fee increase in Option B is unlikely to deter investors because the fees are generally a small part of an investor's total cost, relative to the investment itself. Delays to applications being assessed create significant costs for investors which can outweigh the cost of any fee paid. As a result law firms suggested investors would be prepared to pay higher fees to have their applications considered more quickly.

### Adequacy Statement

The Treasury confirms that the principles of the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements, have

been complied with. The Treasury considers this final RIS to be adequate. This RIS was circulated with the Cabinet paper for departmental consultation.

## **Status Quo and Problem**

### *Status Quo*

The Overseas Investment Act 2005, the Regulations and sections 56 to 58B of the Fisheries Act 1996 regulate certain investments by overseas persons. The OIO, a unit within Land Information New Zealand (LINZ), administers this screening regime.

The OIO has been directed to recover its operating costs from applicants and has done so since it was formed in 2005, as did its predecessor the Overseas Investment Commission.

### *Problem*

Based on current fees, the OIO is expected to incur an operating deficit of \$1.1 million by June 2009, increasing to \$1.2 million by June 2010. This cumulative deficit of \$2.3 million is equal to around 95% of the OIO's annual operating costs.

The main reasons for the forecast deficit under the current fees are:

- **Higher prices (costs)** required to correct significant cost under-estimations since 2005. In the absence of operational experience, the OIO's costs were underestimated when it was formed in 2005 and have in effect been subsidised by other areas of LINZ. LINZ has now more accurately estimated the cost of assessing applications using a new cost model.
- **Lower quantity.** In the last quarter of 2008, the number of applications received by the OIO fell by 25%, coinciding with the onset of the global economic recession. Fewer application numbers mean that fee revenue does not cover the OIO's costs.
- **Improved standards.** Personnel costs have increased as the OIO has increased staff numbers from five to twelve since 2005/06. The additional staff has improved standards by reducing application assessment times to well below previous peaks which benefits overseas investors.

## **Objective**

The objective is to provide sufficient revenue to cover the OIO's operating costs in order to ensure that investment applications are assessed with minimal delay.

## **Options**

The table below outlines three options for fee changes that would cover or partially cover the OIO's costs. Option A would fully recover costs from investors (based on current application numbers), Option B would partially recover costs and Option C would maintain the current fees until the review of the screening regime is completed.

<b>Proposed fee changes</b>			
	Option A: Full cost recovery	Option B: Partial cost recovery	Option C: Maintain current fees
<b>Applications relating to overseas investments in sensitive land</b>			
Consent applications determined by the Regulator	\$19,100	\$14,600	\$8,200
Consent applications determined by relevant Ministers	\$22,000	\$17,100	\$8,700
Initial conditional consent in a series of transactions involving the same vendor or same purchaser	\$17,100	\$12,900	\$8,000
Each consent following the above type of initial consent	\$13,000	\$9,200	\$6,000
Variation of consent/consent conditions determined by the Regulator	\$12,300	\$8,700	\$3,100
Variation of consent/consent conditions determined by relevant Ministers	\$13,100	\$9,300	\$7,600
Exemption by the Regulator under Regulation 37	\$13,100	\$9,400	\$2,200
Exemption by the relevant Ministers under Regulation 37	\$13,300	\$9,600	\$2,500
<b>Applications relating to overseas investments in significant business assets</b>			
Consent for a transaction	\$12,900	\$9,200	\$2,100
Variation of consent or conditions of consent	\$10,900	\$7,500	\$1,200
Exemption under Regulation 37	\$11,700	\$8,200	\$1,300
<b>Applications relating to overseas investments in fishing quota</b>			
Consent for a transaction	\$36,000	\$36,000	\$36,000
<b>Other applications</b>			
Exemption from the requirement to obtain consent by addition of portfolio investors to Schedule 3 of the Regulations	\$10,500	\$7,200	\$1,000
Monitoring compliance with conditions of exemption for each 12 month period following addition to Schedule 3	\$9,500	\$6,200	\$700
Exemption from the requirement to obtain consent by addition of New Zealand Controlled persons to Schedule 4	\$14,500	\$10,500	\$6,000
Monitoring compliance with conditions of exemption for each 12 month period following addition to Schedule 4	\$9,800	\$6,500	\$4,100
<b>Administrative Services</b>			
Information provision	\$164 per hour	\$164 per hour	\$120 per hour

### ***Option A – Fully recover costs from investors***

This option will fully recover the OIO's costs from investors and requires a weighted average fee increase of 178%. Around 35% of the revenue raised in this option would be used to correct previous underestimates of costs. 30% of the fee increase will be used to offset lower revenue due to the recent drop in the quantity of applications. The final 35% will meet the cost of additional staff employed to improve standards by reducing assessment times.

The uncertainty around application volumes means that Option A may, therefore, risk over-recovery of costs in the medium-term.

### ***Option B – Partially recover costs from investors***

Under Option B, fees would increase by a weighted average of 120%. This increase would cover the overhead costs and the cost of the additional staff employed to reduce application turnaround times. This option would not offset the fall in revenue caused by lower application numbers.

If application numbers remain low as forecast, this option will not fully recover the OIO's costs. LINZ forecasts that this option will result in a deficit of around \$700,000 in the 2009/10 year.

This option provides for some recovery of costs from investors while the uncertainty around when application numbers may begin to recover. Increasing fees to offset reductions in volumes of applications is consistent with Treasury and Audit Office Guidelines for setting fees in the public sector, as long as fees do not exceed costs. However the volume reduction may be temporary and there is a high degree of uncertainty about longer term demand.

Any deficit resulting from this option can be funded by reprioritising existing Crown funding within LINZ baselines or providing new funding.

### ***Option C – Defer increase until the review of the screening regime is completed***

The government is undertaking a review of the overseas investment screening regime that may reduce the number and complexity of investment applications. As a reassessment of fees will be required once any changes have been made, it could be argued that a fee increase should be deferred until this time. It is likely to be June 2010 before we will be in a better position to ascertain what impact there has been on application numbers.

A delay will not remove the need for at least some level of fee increase in the future to meet the increased cost of assessing applications.

LINZ forecasts that postponing a fee increase until June 2010 would result in a deficit of around \$1.2 million in the 2009/10 year, which is approximately equal to half of the OIO's total annual operating costs. Funding this deficit from sources other than fees represents a significant move away from cost recovery from overseas investors.

### **Benefits and costs**

The key benefit of fully funding the OIO's costs is that it will allow the Office to quickly assess investment applications and minimise delays for investors. With the additional staff, the OIO is now aiming to assess 90% of all accepted applications within 50 days.

The scope to reduce costs within the OIO to meet any deficit is limited because the size of the required reductions (up to 50%) would require the OIO to significantly reduce its staffing levels. This reduction would increase turnaround times for investment applications and may mean that the OIO is unable to function at all. This would be undesirable, given that encouraging overseas investment is a government priority.

The main cost of Options A and B is the increase in fees paid by overseas investors. In November 2008, LINZ consulted with law firms who represent overseas investors on the fee proposal outlined in Option B in this paper. The consultation suggested that fee increases are unlikely to deter investors because they are generally a small part of an investor's total cost. Consultation indicated that many applicants would be prepared to pay higher fees if their applications were considered more quickly.

The benefit from the expected reduction in turnaround times is likely to outweigh the cost of the fee increase, because the cost of delay to business activity can be high. For example one potential cost would be if the investor hedges their investment capital while seeking consent. Hedging a NZ\$100m investment (the minimum business investment that would be screened) for two months would cost around \$650,000, increasing to \$2 million for six

months.<sup>1</sup> The longer the time taken to seek consent, the greater the cost of hedging, and this cost exceeds the fees paid by the investor. Therefore, the overall costs of an investment are likely to be lower if higher fees allow the OIO to assess applications more quickly.

### **Implementation and Review**

The proposed fee amendments will take effect by mid 2009 through amendments to the Overseas Investment Regulations. Notice of the fees amendments will be communicated towards the target audience (the lawyers who represent applicants) via the New Zealand Gazette, the LINZ website and the New Zealand Law Society's magazine "Law Talk".

A memorandum account is used to track fee-generated revenue to ensure that costs are not under or over-recovered in the medium term. The fees will next be scheduled for review in 2011/12.

Officials will also monitor fee revenue between now and 2012. There may be a need to review fees sooner, if the outcome of the current review of the overseas investment screening regime, or other factors, such as global economic conditions, result in significant changes to the number or complexity of applications.

### **Consultation**

The following organisations were consulted on the fee increases proposed in Option B in October/November 2008: the New Zealand Law Society Property Law Section, Business New Zealand, and Investment New Zealand.

Additionally, the following law firms who regularly advocate for overseas investors across the range of investments considered under the legislation, were consulted on fee changes in October/November 2008: Chapman Tripp, Bell Gully, Russell McVeagh, and MinterEllisonRuddWatts.

No concerns were expressed with the fee increases as consulted on in October/November 2008. The proposed fee increases in Option A are around 30% higher than what was proposed in the October/November consultation. This is because since that consultation, a steep reduction (of around 25%) in overseas investment application numbers, coinciding with the recent deterioration in global economic conditions.

The State Services Commission, the Ministry of Economic Development, the Ministry of Fisheries and the Ministry of Foreign Affairs and Trade were consulted in the preparation of this RIS. The Department of the Prime Minister and Cabinet has been informed of the proposals.

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<sup>1</sup> Based on calculations of a forward contract rate from <http://fxconsulting.oanda.com> and exchange rates at 30/03/2009.