THE ICEHOUSE
WHERE KIWI BUSINESSES GROW

INVESTOR MIGRANT POLICY - September 2015

Introduction

The paper proposes changing New Zealand's Investor Migrant Policy to channel a portion of wealthy migrant investment into supporting New Zealand's strategic capital needs which currently include providing capital for our emerging growth companies.

Economically, New Zealand has been well positioned over the last few years compared to the rest of the world. This has been both good management and fortune. More recently, with falling commodity prices and growth challenges, it has become apparent that we need to do more to maintain let alone improve our competitive advantage. New Zealand's economy suffers from a lack of large companies exporting a diversified range of goods and services. There are just over 2300 firms with more than 100 employees. These large firms by NZ standards are significantly smaller than those of comparative countries and their market focus is more heavily oriented towards the domestic market. We need to grow our base of large companies exporting to the world, both scaling our existing and creating more – arguably we need 3000 of them - and we need to find a way to enable the next generation of emerging companies to do this more effectively and quickly with hundreds not just a few coming through to success.

KEY POINTS

It is estimated that over the next few years to 2020 emerging growth companies will have a gap of $2 billion of new investment to enable their growth.

Just as immigration is used to fill gaps in the labour market, it can be deployed to fill gaps in our capital and investment markets.

Other countries welcome migrants that invest in growth opportunities. So should New Zealand.

New Zealand's capital gap

A major challenge for the next generation of high growth, globally oriented New Zealand companies is raising capital for early growth and offshore expansion[1]. It is estimated that over the next decade emerging growth companies will need billions of new investment. Because of the small size of New Zealand's capital markets – particularly the early stage angel, venture capital and growth capital sectors - as little as 50% of that capital is likely to be available for investment based on the current figures – we are talking about a gap that we can sight today of over $2 billion. Over the last ten years of investment and activity in New Zealand's innovation ecosystem, we have created a problem for ourselves: there are opportunities coming to the surface which are seeking capital. This is creating an impending gap and a real risk in the potential being unfulfilled.

However, a possible new source of funding for high growth, global market oriented companies are the funds that come into New Zealand through investor migrants each year. Currently, the majority of the existing investor migrant funds end up in passive investments - 'lazy money' – and in relatively unproductive sectors – bank accounts and bonds. They are not being employed into the areas where New Zealand has a need and could develop a strategic advantage - and without delivering to

[1] Capital is just one of the challenges these firms face – see Andrew Hamilton's paper NZ's Hidden Metric https://www.theicehouse.co.nz/andys-blog-nzs-hidden-metric/ which discusses some of the other challenges.

this potential we face a continuing challenge with respect to our competitive advantage. New Zealand needs to take advantage of every opportunity to improve our position. Changing the rules on entry and for allocation could better align investment with the need to grow New Zealand's economy and to increase its productivity, while aligning a stream of investment from the private sector, rather than relying on the Government to step in. Further, the current government is looking to significantly increase the quantum of investment brought into New Zealand by investor migrants and this creates an opportunity for even greater impact and alignment to fuel NZ's prosperity.

Current policy settings

An investor migrant policy which attracts and facilitates these high value migrants is important but getting the settings right so that their contribution is maximised is difficult. Under the current criteria, the Migrant Investment Policy aims to attract financial capital by providing residence to people who wish to make a significant financial contribution to New Zealand's economy. It is divided into two categories:

- The Investor 1 category requires a minimum investment of $10 million to be invested in New Zealand over 3 years.
- The Investor 2 category requires a minimum of $1.5 million to be invested in New Zealand over 4 years. Applicants must also bring $1 million in settlement funds.

Since the policy was introduced in 2009, around 570 applications have been approved bringing in $1.6 billion of investment. Around 300 applications have been approved in principle, with a value of $770 million. Another 670 applications are under consideration, representing another $1.1 billion. Combined, the investor migrant investment pipeline is worth $3.5 billion[2].

The current rules require the capital to be deployed in a range of investments selected by the migrants from bond products, equity in New Zealand firms (public or private including managed funds), or interest bearing instruments in New Zealand registered banks, or residential property development. Under this relatively light-handed regime, around 85% of the funds have gone into bonds, providing general banking liquidity (which assists property lending), but otherwise sitting there lazily, before coming out after a three or four year period. Very little is invested into areas which increase New Zealand's productivity and in comparison to other country's investor migrant policies we are out of step. We need to be ahead - not behind - to improve New Zealand's productivity.

International situation

Immigration policy is by its very nature interventionist. Criteria for entry for skilled migrants are deliberately skewed towards attracting migrants in areas where skills shortages exist. In the same way, surely, investor migrant policies can be skewed towards areas where capital shortages exist. This is what is already happening in other jurisdictions.

New Zealand needs to consider following the example of other countries like Australia, Canada, the USA, and Britain. Australia has just amended its version of this migrant category - its 'Significant Investor Scheme'. Changes were made because – as is happening in New Zealand - most of the funds from the scheme have typically flowed into government bonds and to some extent residential real estate schemes.

Australia now requires wealthy migrants to invest at least AU$500,000 (10 percent of the AU$5 million total they must invest) in venture capital or growth private equity funds. This is expected to rise to a minimum of AU$1 million (20 percent) within two years. Another AU$1.5 million must be invested into eligible managed funds or listed investment companies that invest in smaller companies listed on the Australian Securities Exchange. The balance of funds can then be invested in other listed companies, corporate bonds, annuities or real assets, subject to a limit on property

[2] Note, recently the NZ Government have set a target of $7b.

investment. Australia even goes further, with requiring the investor migrants to pay a one-time economic development levy of AU$250,000.

The changes are not expected to deter future applicants and the Australian government is expecting to continue to grant visas at the current rate of around 1000 each year. Australia's scheme has seen over 90% of its Significant Investor Scheme visas going to Chinese and Hong Kong migrants. Many of these people are primarily motivated by lifestyle and related factors – rather than the investment criteria under which they gain entry.

It is expected these changes will contribute around $300 million of funds towards new venture capital and private equity funds. This represents a significant boost to these sectors – a potential game changer.

Alongside the changes brought in by Australia, the United States EB-5 programme, which requires investment into job-creating ventures, is over-subscribed. Canada's Immigrant Investor Venture Capital Fund Program was launched in January. It requires a C$2 million ($2.34 million) investment in venture capital and has a limited number of places. The United Kingdom's investor category prohibits the UKP750,000 (around $1.78 million) of required investment going into property investments and banks.

How it could be done

The opportunity for New Zealand is to align immigration policy with the need to shift the New Zealand economy towards priority areas such as technology and high growth, high productivity companies. Migrant capital can be utilised to help tackle large gaps in our capital and investment markets. What is equally important is that there is a shift in responsibility for funding critical gaps in the economy from solely the Government to migrants, and the changes in policy provides an annuity opportunity year on year from these migrants. This would mean there is much greater alignment between immigration settings and the Government's Business Growth Agenda.

There are a number of options that could be considered:

1. Introduce a new Investor 3 migrant category. This could sit alongside the existing Investor 1 and Investor 2 categories. The new category could require an investor to invest a minimum of $5 million in New Zealand, of which 10-20 percent must be allocated to growth capital investments (angel, venture capital and small cap private equity funds). In return, other requirements would be reduced or eliminated (as occurs currently for Investor 1 migrants).
2. Amending the existing Investor 2 category so that a 10-20 percent investment in growth capital funds either contributes a greater number of points and/or reduced other requirements for entry under the visa. For example, migrants investing $300,000 into growth capital might earn 40 points towards their applications.
3. Amending the existing Investor 1 category requiring a 10 (or even higher) percent investment in growth capital funds or direct investments. Any migrant investing $10 million will be relatively sophisticated and have the capacity to make such an allocation to a growth investment.
4. Amending the existing Investor 1 and 2 categories by creating a negative percent investment test – for example, "not more than 70% into interest bearing bank instruments" would get the intent into a similar place.

How allocations to growth investments would be managed is a matter for further policy design but there are a number of options. It could be managed by having a number of approved fund managers (as is required in Australia and Canada), or through an approved fund-of-fund mechanism. The latter would then diversify the wealthy migrants' capital across a number of funds while there would also be diversification risk across the three priority areas. This would mitigate the investment risk. It is likely that sophisticated Investor 1 migrants would be able to actively manage their own investments.

What it would achieve

It is estimated that on the basis of the proposed settings at the 10% level, such a policy could bring in between $50 million and $100 million a year to be invested into New Zealand's growth capital markets. Increasing the settings by a factor of two over time would create an even more significant impact. This would be a significant boost to the development of the early stage investment sector and also provide the opportunity for other sector needs over time. The sector's ability to absorb and deploy this level of capital has strengthened considerably over the last decade. Most importantly, it would be of considerable benefit to start-ups and young growth companies seeking capital by boosting the investment capital available for building New Zealand-based internationally capable businesses.

While early stage investment is high risk compared with bonds and bank deposits, the proposal is for it only to involve a proportion of investor migrant funds with the balance (80 to 90 percent) invested in less risky asset classes.

Requiring or encouraging investor migrants to growth capital funds could be a first step. If successful, the government could consider other requirements depending on where capital shortages exist in the New Zealand market.

It could be argued that stricter investment rules will mean that wealthy migrants will bypass New Zealand for friendlier regimes elsewhere. This ignores the fact that the changes we propose remain less onerous that those regimes in countries with whom New Zealand competes for migrants. The proposed changes only apply to a small proportion of the investment capital. Eighty to 90 percent would be invested as it currently is. New Zealand would remain a very attractive proposition to wealthy would-be migrants, regardless of the stringency of the settings around the policy. It is also important, in our view, that as a country we need to be confident about the opportunity we provide for migrants to move here. We want the right type of migrants and not those focused purely on the deal they can achieve to get into a country.

Conclusion

If implemented, the changes would be a departure from the light-handed regime which has been in place. While it is clearly more prescriptive, it is also clear that the proposed changes are better aligned to New Zealand's economic needs and the Government's priorities. Currently we are missing an opportunity and suffering loss from the lack of effective utilisation of the migrant funds. Moreover, if New Zealand is offering wealthy people the opportunity to avoid other criteria under the normal migrant points system to gain residency, then it can insist on criteria which maximises the gains for New Zealand and directs the capital into growing the sort of companies New Zealand needs as it looks to increase productivity and build more world-class technology companies.

Such a policy is unashamedly pro 'New Zealand Inc.' and aspirational. It would say to wealthy would-be migrants that they are welcome here, but they need to invest in the New Zealand growth opportunity. Furthermore, if the goal of a migration policy is to attract residents committed to building lives and wealth in New Zealand over the long term, then there is alignment in having a requirement to invest part of their wealth into longer-term, 7-10 year investment funds and companies which are focused on long term growth.

People want to live in New Zealand for a variety of reasons, but always on the list is their liking for the relaxed lifestyle, great quality of life, a stable and open system of government, and beautiful environment. The price for that could be an investment in building more companies like Xero, Rocket Lab and Vista Entertainment, to continue the progress towards building an enviable economy which will then become in itself an attraction to future generations of migrants.

When an opportunity is in front of you as simple as this to make a significant impact it needs to be taken.