

Inbound US Real Estate Investments To Face New Oversight

By **Chelsea Naso**

Law360 (January 28, 2020, 6:41 PM EST) -- A broad portion of U.S.-targeted real estate transactions will soon fall explicitly within the reach of the Committee on Foreign Investment in the United States for the first time, adding a new level of scrutiny to inbound deals.

The U.S. Department of the Treasury published new CFIUS regulations this month to implement the Foreign Investment Risk Review Modernization Act of 2018, or FIRRMA, to give the committee "the ability to better address national security concerns arising from certain investments and real estate transactions."

Much of the attention regarding the latest rules, which take effect Feb. 13, has focused on how reviews will change for U.S. mergers and acquisitions by foreign investors. But the new regulations also explicitly expand CFIUS' jurisdiction to include real estate transactions that do not involve the acquisition of or investment in a U.S. business.

"The simple fact that CFIUS now has authority to review standalone acquisitions of U.S. real estate is a very noteworthy development," said Shearman & Sterling LLP CFIUS partner John Beahn. "Traditionally it was the case that CFIUS would only review acquisitions of real estate in connection with some corporate transactions. But that has now changed."

Pure Real Estate Deals Are Now in CFIUS' Reach

The Treasury Department is implementing FIRRMA through a series of regulations: the first, known as Part 800, covers foreign investments in U.S. businesses, and the second, known as Part 802, covers pure real estate transactions. A third set, known as Part 801, was used to install a pilot program to test mandatory filings for investments in critical technologies.

Foreign investments in real estate will fall under the guidelines set out by Part 802 when there is no acquisition of a U.S. business involved, otherwise they would be reviewed under the new 800 regulations.

It is important to note that CFIUS' jurisdiction does not extend to every single U.S. real estate transaction involving a foreign investor. CFIUS will be able to review the sale, lease or concession to a foreign person or entity who is granted three of four property rights: the right to physically access the property, to prevent others from physically accessing the property, to improve or develop the property,

or to affix structures and objects to the property.

CFIUS can also review transactions in or within a certain distance of specific airports, maritime ports and military installations, as well as missile fields and offshore ranges.

"The primary goal was to put these types of transactions within CFIUS' jurisdiction because of national security concerns about acquisitions of real estate in proximity to critical infrastructure, like airports, and military facilities. CFIUS didn't have a way to review those transactions before FIRRMA," said David J. Ribner, an O'Melveny & Myers LLP CFIUS counsel.

"To the extent that consideration of CFIUS is becoming the norm in M&A transactions or private equity investments involving foreign parties, where it's something you need to think about, CFIUS should also be considered in the real estate world when there is a foreign buyer," Ribner said.

There is an array of exceptions to CFIUS' jurisdiction, including transactions involving a single housing unit, the lease or concession of real estate in airports and maritime ports for retail purposes or the purchase, lease or concession of certain commercial space in a multi-unit commercial building.

"They're trying to strike the right balance and not have too many filings, and they want to be able to focus on the important ones," said David Hanke, an Arent Fox LLP partner who helped craft FIRRMA before joining the firm.

Specifics Provided for Proximity Concerns

Proximity is not a new concept to CFIUS. It has been a sticking point in previous CFIUS reviews involving real estate, when the committee has concerns about a foreign entity's ability to access or otherwise surveil a sensitive U.S. facility.

The new regulations bring the idea of proximity into CFIUS' new jurisdiction over pure real estate transactions and go a step further by clearly defining sensitive locations and the proximity to those locations that could cause national security concerns.

The Treasury Department divides it into two distances. Close proximity is considered to be within one mile of certain sensitive facilities. Other facilities are subject to an extended range of 100 miles. Which facility falls into which range is determined by lists included in a series of appendices published by Treasury alongside the regulations.

There is an expectation that Treasury will release a tool that will help better determine proximity, to make sure there aren't inconsistencies in how the parties and CFIUS are measuring the distances.

"While the regulations offer some geographic certainty by identifying locations in the appendix and distance ranges through the close proximity and extended proximity definitions, it appears that measuring distance ranges from the outer perimeter of identified locations requires a level of precision that will be difficult for transaction parties to achieve if there are close calls," said Heather Finstuen, a Covington & Burling LLP CFIUS of counsel.

For now, it's unknown what effect the proximity rules, particularly the extended range, will have on inbound investment in real estate.

"This is quite an extensive list of military bases and seaports and airports. There is a possibility, maybe even a likelihood, this will chill at least some foreign investment in real estate near these facilities, but I think trade-offs were made and they tried to be surgical with regards to the types of transactions they swept up. Hopefully the chilling effect is limited," Hanke said.

'Excepted Investor' Concept May Ease Reviews for Some

Similar to the regulations covering M&A activity, the final regulations for the first time name three countries — the U.K., Australia and Canada — as "excepted real estate foreign states," meaning that some acquirers from those countries would be exempt from certain aspects of FIRRMA.

The designation — which Treasury said "furthers the committee's efforts to encourage partner countries to implement robust processes to review foreign investment in their countries and increase cooperation with the United States" — is for a two-year period. CFIUS plans to review the process before deciding who will remain on the list and whether or not it will add to the list.

Certain acquirers from the three excepted real estate foreign states may be considered excepted real estate investors if they meet specific criteria, including having no more than 25% of board members from other jurisdictions and limiting an individual investor's holding in the excepted investor to 10%.

"As under Part 800, under Part 802 there is an excepted investor exception, which will apply to certain investors with sufficiently close ties to Australia, Canada or the U.K., under somewhat complicated rules that govern that analysis," said Richard Matheny, who heads Goodwin Procter LLP's global trade practice.

While the designation is seen as particularly helpful under the rules governing M&A because of the introduction of mandatory filings in certain critical areas, it's unknown how much of an effect the designation will have in the world of real estate.

"I'm just not sure how much utility that will have, because I don't know [that] an investor from Canada that is going to lease property that's in the scope of the Part 802 regulations would voluntarily file anyway. So I'm not sure the exemption is doing that much work," Matheny said.

Filing Process Voluntary for All Real Estate Deals

There are, as of now, absolutely no mandatory filings for pure real estate transactions. Like pre-FIRRMA CFIUS, the committee can always bring in a transaction and even unwind it after closing, but there is no requirement that parties file upfront.

"The CFIUS process for these types of transactions is voluntary. So parties will have to undertake the customary risk-based assessment in determining whether to seek CFIUS review for a real estate transaction or not. There are at least at this point no mandatory filings for covered real estate transactions," Beahn said.

The final regulations do, however, allow for short-form declarations, a more brief filing with a shorter review window. The hope is that the declarations will allow deals unlikely to raise national security concerns be notified to CFIUS in a way that is less burdensome to both the filing parties and the committee.

"It's also fair to say that there are concerns that expansion of CFIUS jurisdiction to covered real estate transactions could end up resulting in many more filings with CFIUS. I think there is a view by doing it through this short-form process it would be a way to better manage CFIUS' resources so they can focus on some of the more complex or high-profile transactions," Beahn said.

But the short-form declaration is relatively untested. It was introduced as part of the pilot program, which required mandatory filings for foreign investments in critical technologies. The sensitivity of critical technologies made it less likely that a short-form filing would be the best bet, since if CFIUS has concerns parties can find themselves back at square one filing a full notice and restarting the review timeline.

"With the critical technologies pilot program, I think the reason that a lot of people haven't availed themselves of the declaration is there is no guarantee you'll get an up or down decision from CFIUS. If you definitely want an up or down, you have to file the joint voluntary notice," Hanke said.

Real estate transactions are less likely though to present the concerns than investments in critical technologies.

"But with real estate, especially if you just want that safe harbor, that certainty that CFIUS won't come back later and try to unwind your deal, you will be able to use the declaration and not have to pay quite as much money or wait quite as long for a response from CFIUS," Hanke said.

It may take some time to gain traction until real estate transactions start to test the process.

Questions Remain About Mitigation Possibilities

Like in reviews involving M&A, CFIUS has the ability to mitigate real estate transactions that present certain national security concerns without blocking the deal outright.

But it remains to be seen what mitigation options would be effective in a real estate situation and whether or not CFIUS would choose those options over preventing a sale, lease or concession from moving forward.

"A big unknown is how the CFIUS threat analysis and CFIUS' mitigation powers will play out as CFIUS reviews a real estate transaction under its new authorities," Finstuen said. "In my mind a big question is whether CFIUS will have a full range of mitigation tools as it does for covered transactions or will its options really in practice be limited to blocking transactions."

It's still unknown not only how CFIUS will handle mitigation, but also how many transactions will be swept up in the review process and how all of the rules will be interpreted until they are tested by actual transaction parties.

"While the potential for capturing transactions is high, it remains to be seen how many will actually be captured and how many filings will be made. I think it will be interesting to see how that develops," Finstuen said.

--Editing by Orlando Lorenzo.