Foreign Ownership of Real Estate: New Rules from CFIUS

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On January 13, 2020, the Committee on Foreign Investment in the United States published final rules governing the foreign acquisition and ownership of real estate, with far-reaching consequences for both real estate purchasers and would-be landlords to the federal government. Although the final regulations largely follow the proposed regulations issued on September 17, 2019, several changes have been introduced in response to comments by interested parties. This article addresses the recent changes introduced by the Foreign Investment Risk Review Modernization Act of 2018 and the final rules with respect to foreign acquisition of real estate, which will affect a large number of real estate transactions.

The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") amended the rules governing the Committee on Foreign Investment in the United States ("CFIUS") to provide the Committee with the authority to review minority foreign investments in certain U.S. businesses, as well as certain real estate transactions, departing from the traditional focus on foreign control over a U.S. business. FIRRMA also mandated that CFIUS issue new rules governing the scope of its review authority. On September 17, 2019, CFIUS published proposed rules governing the foreign acquisition and ownership of real estate, with far-reaching consequences for both real estate purchasers and would-be landlords to the federal government. The Final regulations were published on 1/13/20, and become effective on Feb. 13, 2020. CFIUS also published an interim rule on the definition of "Principal place of business" with a 30-day opportunity to comment.

At a high level, the changes introduced by FIRRMA and the final rules are:

1. FIRRMA and the final rules expand CFIUS jurisdiction with respect to real estate, particularly undeveloped land, and allow CFIUS to make forecasts about future use of undeveloped land;

2. The final rules create a set of exceptions, including a new category of excepted real estate investors, favoring U.S. close al-

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lies with established investment risk reviews and compliance records;

3. A real estate covered transaction will not trigger a mandatory filing requirement;

4. Parties may choose between a short-form declaration and a complete notice, each of which could result in CFIUS concluding all actions under Section 721 of the Defense Production Act; and

5. The CFIUS reform with respect to real estate transactions builds on a trend from the last few years of increased scrutiny in leasing office space from foreign owned or controlled lessors by CFIUS and the federal government.

This article addresses the recent changes to the laws governing foreign acquisition of real estate in several parts. The first part describes the current state of the law, with an analysis of the federal government's increased scrutiny of foreign acquisition of U.S. real estate in recent years. The second part analyzes the new rules governing CFIUS expanded jurisdiction over real estate transactions. The final part discusses the new controls of foreign ownership of federally leased properties.

A Brief History of CFIUS Increased Scrutiny of Real Estate

Congress established CFIUS in 1975, with a mandate to review and — if necessary — block any "covered transactions" involving the acquisition of U.S. businesses that would result in foreign control and might pose a threat to U.S. national security.[1] Under the old standard, a "covered transaction" was any transaction that was proposed, pending or concluded by, or with, any foreign person, which could result in control of a U.S. business by a foreign person.

Before the passage of FIRRMA, CFIUS had only limited authority to review real estate transactions. Covered transactions could include the purchase of real estate, but only when such real estate constituted a "U.S. business." For example, the sale of leased property that generates revenue could be determined to be a covered transaction, and indeed that was how CFIUS approached its early real estate oversight responsibilities. Purchases of undeveloped and unleased property were outside the scope of CFIUS jurisdiction.

The first high-profile CFIUS investigation focusing on proximity to a sensitive government facility as opposed to the acquired business itself was the 2012 Ralls Corp. acquisition of a windfarm in Oregon located within a few miles of a U.S. Navy base where the Navy conducted drone tests. The parties did not file with CFIUS until after closing, and only at the direction of CFIUS. On September 28, 2012, President Barack Obama issued an order requiring Ralls, a Chinese-owned entity, to divest itself of ownership of the windfarm within 90 days, and blocked the use of any wind turbines manufactured by Ralls at the sites in question. Furthermore, Ralls was instructed to hire an independent third party, approved by CFIUS, to remove any installations on the land under CFIUS supervision. The unstated concern was that the windfarm was too close to the Navy base and could be used for espionage on Navy operations.

In 2014, the Chinese-owned Anbag Insurance Group purchased the Waldorf Astoria

hotel in New York. Learning from the Ralls decision, the parties submitted voluntarily to CFIUS review. Waldorf Astoria serves as the official residence of the U.S. ambassador to the United Nations, and also serves as an unofficial meeting place for diplomats from around the world in town for UN business. In February 2015, CFIUS approved the acquisition.

More recently, in 2017, COSCO Shipping Holdings Co., Ltd. ("COSCO"), a Chinese shipping company, filed with CFIUS, seeking approval for the acquisition of a controlling interest in Hong Kong-based ocean container shipping company Orient Overseas International Ltd. ("OOIL"). OOIL had a long-term concession for the operation of a container terminal in Long Beach, California. CFIUS ultimately approved the acquisition on the condition that ownership of the Long Beach terminal would be transferred to a trust whose principal trustee was a U.S. citizen for the purpose of selling to an approved third party.

In all three cases, CFIUS adopted the standard of *close proximity* to a sensitive facility, either directly occupied by the U.S. government, or being part of a major port. This has become the basis for the expanded CFIUS jurisdiction introduced by FIRRMA.

FIRRMA and the CFIUS Proposed Rules Affecting Real Estate Transactions

FIRRMA provided CFIUS with the authority to review real estate transactions — to include leases, sales, and concessions — assuming such transactions involve air or maritime ports or properties that are in "close proximity" to sensitive U.S. government facilities. The final rules implement the FIRRMA changes.[2] However, in the final rules, CFIUS combines the definitions for "airport" and "maritime port" into a new term, "covered ports." The final rule will take effect on February 13, 2020.

The final rules on real estate transactions follow in structure the existing CFIUS regulations at 31 C.F.R. Part 800. This section summarizes some of the most important changes introduced by FIRRMA and developed in the final rules.

Covered Real Estate Transactions

Prior to FIRRMA, CFIUS had jurisdiction to review foreign investments in U.S. real estate only in situations of acquisitions resulting in foreign control over a U.S. business. Under FIRRMA, CFIUS jurisdiction is expanded to include transactions involving the purchase or lease by, or a concession to, a foreign person of certain real estate in the United States, even in transactions in which there is no accompanying investment in a U.S. business.

The final rule defines "Covered Real Estate Transactions" as any purchase or lease by, or concession to, a foreign person of covered real estate that 1) is, is located within, or will function as part of, a covered port; or 2) is located within certain proximity of specific military installations or other U.S. government sensitive facilities, and that affords the foreign person at least three of the following property rights, "whether or not shared concurrently" with another party:

- To physically access the real estate;
- To exclude others from physical access to the real estate;
- To improve or develop the real estate; or

- To attach fixed or immovable structures or objects on the real estate.[3]

Covered Port

The final rule defines "covered port" in a number of ways. The definition describes any port that is:

- Listed in the Federal Aviation Administration's ("FAA") annual final enplanement data as a "large hub airport" or a "joint use airport";
- Listed in the FAA's annual final all-cargo landed weight data as an airport with annual aggregate all-cargo landed weight greater than 1.24 billion pounds;
- Any port described by Maritime Administration as a commercial strategic seaport within the National Port Readiness Network; or
- A top 25 tonnage, container, or dry bulk port as described by the Bureau of Transportation Statistics.[4]

While acquisitions of a covered port would have been considered an investment in critical infrastructure under existing CFIUS regulations, FIRRMA and the final regulations expand the scope of reviewed transactions significantly to cover the acquisition of real estate located within the port, or that could function as part of or as a port. These changes allow CFIUS to speculate about the future use of undeveloped real estate.

Within Close Proximity of Military Installations and Other Sensitive Facilities

To assist the public in identifying the specific sites that meet the definition of "military installation," the names and locations of the military installations are listed in Appendix ("App") A to the proposed regulations and cover real estate located within:

1) Close proximity of certain military installation or sensitive facility (App. A, parts 1 and 2);
2) The extended range of certain military installations (App. A, part 2);
3) Any county or other geographic area identified in connection with certain military installations (App. A, part 3); or
4) Any part of certain military installations located within the limits of the territorial sea of the United States (App. A, part 4).

The terms "close proximity" and "extended range," which are introduced for the first time in the proposed regulation, and which are retained in the final, apply to specific types of military installations as described in the regulations. Covered real estate transactions include those effected within "close proximity" of 1) naval surface, air and undersea warfare centers and research laboratories and major annexes thereof; as well as 2) Air Force bases administering active Air Force ballistic missile fields, and those effected within "extended range" of:

1) Army combat training centers located in the continental United States;
2) Major range and test facility base activities as defined in 10 U.S.C. 196;
3) Military ranges as defined in 10 U.S.C. 101(e)(1) that are owned by the U.S. Navy or U.S. Air Force; or

4) Joint forces training centers that are located in any of the following states: Oregon, Nevada, Idaho, Wisconsin, Mississippi, North Carolina or Florida.

The identification of these categories of real estate is noteworthy, reflecting the increased attention paid by various U.S. government agencies, including the Government Accountability Office ("GAO") and the General Services Administration ("GSA"). While the Trump Administration has been firm in its messaging that FIRRMA is meant to "close gaps" between the transactions that CFIUS is currently able to review and transactions it currently cannot review, those "gaps" largely reflect a perceived risk from unique Chinese investment trends, including real estate acquisitions in sensitive areas.

Exceptions

Excepted Real Estate Transactions

Both FIRRMA and the final regulations[5] provide that certain real estate transactions will be exempt from CFIUS jurisdiction. CFIUS has provided more clarity and detail with respect to exempt transactions, which include:

- Transactions of an excepted real estate investor;
- Transactions that are otherwise covered by CFIUS jurisdiction to review a transaction under Part 800;
- With certain limitations, transactions that relate to real estate within urbanized areas or urban centers;
- Transactions that relate to a single housing unit, including fixtures and adjacent land as long as the land is incidental to the use of the real estate as a single housing unit;
- The lease or concession of real estate to a foreign person if:
  - The foreign person is a foreign air carrier, but only to the extent that the lease or concession is in furtherance of its activities as an air carrier; or
  - Used only for the purpose of engaging in the retail sale of consumer goods or services to the public.[6]
- Transactions that relate to commercial office space within a multiunit commercial office building, if such space would not exceed 10 percent of the total square footage of the total commercial space, and the foreign person does not represent more than 10 percent of the total number of tenants in the building; and
- Transactions that relate to land owned by American Indian or Alaska Native groups.

Note that just because a real estate transaction might be exempt because the real estate is located within an "urbanized area" or in an "urban cluster," it does not necessarily mean that the transaction would not be covered under CFIUS general jurisdiction to review acquisitions that would result in foreign control over a U.S. business. FIRRMA expanded CFIUS jurisdiction so that the exceptions only apply to qualifying transactions that were captured as a result of the expansion.

In addition to the exceptions identified above, lending or other financing by a foreign person to another person for the purpose of the purchase, lease, or concession of covered real estate will not by itself constitute a

covered real estate transaction.[7] Similarly, convertible instruments would be subject to CFIUS review only upon the time of imminent conversion of such interest.[8]

Excepted Real Estate Investor

Of particular note is the carve-out with respect to "excepted real estate investors."[9] Under the proposed rules, an excepted real estate investor is

- A foreign national who is a national of an excepted real estate foreign state and is not also a national of any foreign state that is not an excepted real estate foreign state,
- A foreign government of an excepted real estate foreign state, or
- A foreign entity[10] organized under the laws of, and with its principal place of business in, an excepted real estate foreign state or the United States, and 75% of members or observers of its board of directors are U.S. nationals, or nationals of an excepted real estate foreign state and are not also nationals of any other foreign state.

Special aggregation rules apply if there is more than one foreign entity party to the transaction. The exception would not apply if the foreign investor has provided false information to CFIUS, violated any mitigation agreement with CFIUS, violated U.S. export control laws, or committed a felony crime in the U.S.

CFIUS will maintain a list of excepted real estate foreign states, which may be updated from time to time, and to be published in *Federal Register*.[11] In the FAQs on the final rule, CFIUS proposed to include Australia, Canada, and the United Kingdom on the list. Beginning February 13, 2022, CFIUS may add other countries to the list.[12] An important factor in determining if a foreign state qualifies to be added to the list will be whether the foreign state has established and is currently using a robust national security review process itself. The countries on the initial list will have two years to ensure that their national security-based foreign investment review process and bilateral cooperation with the U.S. on such a process meet the requirements of the new regulations.[13]

Filing of a Declaration or Notice

Parties to a covered real estate transaction may submit a voluntary declaration under the proposed rules. Unlike Part 800, which contains the proposed rules with regard to other types of "covered transactions," there will be no mandatory reporting requirement. Outside that requirement, the filing process for the two parts is largely the same. Parties may file a full notice, which is the most thorough application for CFIUS review and will provide the parties with a safe harbor following completion of CFIUS review. Alternatively, parties may file a declaration, which is a short filing generally not to exceed five pages.

One potential benefit is that declarations do not require detailed personal information about the directors, officers, and owners of the foreign investor, the gathering of which can often delay the filing process. CFIUS has 30 days to review a declaration and decide how it wants to proceed, which allows for the possibility of a shorter review. On the other hand, by filing a declaration as opposed to a complete notice, the parties take the risk that at

the end of the 30-day review period, CFIUS might direct the parties to submit a full notice, which will start a new 45-day period of review, which might be followed by a 45-day investigation period. Additionally, CFIUS might decide that the transaction is covered under Part 800 of the CFIUS regulations, and require from the parties information other than that required for real estate covered transactions. According to the proposed rules, a transaction that may be subject to CFIUS review will not be subject under both Parts 800 and 802. A covered transaction under Part 800 that includes the purchase, lease, or concession of covered real estate is not a covered real estate transaction under Part 802. Therefore, if a transaction is subject to Part 800, the parties must determine whether it is appropriate to notify CFIUS of a transaction under those regulations and not under Part 802, even if it includes real estate.

Increased Scrutiny of Foreign Ownership of Federally Leased Properties

In addition to increased CFIUS scrutiny of real estate transactions, the government has focused more attention on the risks associated with the foreign ownership of property leased to the federal government. The federal government currently leases much more commercial office space than it owns, and the GSA serves as the primary lessee for the government's various agencies, which are tenants in GSA leases.

GAO issued a report[14] in January 2017 that highlighted the risks associated with foreign ownership of real property. In "FEDERAL REAL PROPERTY: GSA Should Inform Tenant Agencies When Leasing High Security Space from Foreign Owners," GAO profiled the risks associated with foreign ownership of federally leased property. GAO concluded with a recommendation "that the Administrator of the [GSA] determine whether the beneficial owner of high-security space that GSA leases is a foreign entity and, if so, share that information with the tenant agencies so they can adequately assess and mitigate any security risks." GSA concurred with this recommendation.

The GSA, as the government's largest lessee of commercial real estate, has since taken at least one concrete step in identifying foreign ownership. As part of GSA's procurement package for federal leases, it now includes a form entitled "Foreign Ownership and Financing Representation (Acquisitions of Leasehold Interests in Real Property)." This form requires would-be lessors to the government to disclose whether there are any foreign persons, foreign-owned entities, or foreign governments in the ownership structure of the offeror or its lenders / financers. Other federal government contractors who are required to register in the System for Award Management ("SAM") are required to disclose foreign ownership in a less contract-specific manner. Registration requires disclosure of a company's immediate owner and ultimate owner, thus providing the government with some visibility into the existence of foreign ownership.[15]

Conclusion and Takeaways

The final CFIUS regulations are likely to have profound impacts on transactions involving U.S. real estate. The changes to the scope of "covered transactions" have resulted in increased CFIUS jurisdiction. The "close proximity" definition issued by CFIUS will undoubtedly affect GSA-leased properties and

other properties with national security-sensitive U.S. government agencies as tenants. As an addition to the already existing Federal Acquisition Regulation and GSA policy requirements for communicating ownership to the government, expanded CFIUS jurisdiction over real estate transactions will generate additional risk analysis for foreign-affiliated purchasers of federally leased property.

NOTES:

[1]50 U.S.C. § 4565 et seq, *available at* https://www.govinfo.gov/app/details/USCODE-2015-title50/USCODE-2015-title50-chap55-subchapIII-sec4565.

[2]31 C.F.R. Part 802.

[3]31 C.F.R. § 802.212 and § 802.233. Change in a foreign person's ownership rights that would affect any three of the above, or transactions structured to evade CFIUS jurisdiction are also covered transactions. *See also*, Proposed 31 C.F.R. § 802.211.

[4]31 C.F.R. 802.210.

[5]31 C.F.R. § 802.216.

[6]31 C.F.R. 802.216(e)(1)-(2).

[7]31 C.F.R. § 802.303.

[8]31 C.F.R. § 802.304.

[9]31 C.F.R. § 802.215.

[10]This rule covers all of the parent companies or individual shareholders that hold five percent or more voting power or other control over the foreign entity.

[11]Proposed 31 C.F.R. § 802.214.

[12]Frequently Asked Questions on Final CFIUS Regulations Implementing FIRRMA, Jan. 13, 2020, *available at* https://home.treasury.gov/system/files/206/Final-FIRRMA-Regulations-FAQs.pdf.

[13]31 C.F.R. 802.214; 31 C.F.R. 802.1001.

[14] https://www.gao.gov/products/GAO-17-195.

[15]48 C.F.R. § 4.18.