

ALERT

CFIUS to Scrutinize More Real Estate Transactions Involving Foreign Persons Under New Rules

September 26, 2019

On Tuesday, September 17, 2019, the U.S. Department of the Treasury (Treasury) issued proposed regulations to implement the Foreign Investment Risk Review Modernization Act (FIRRMA), a law that significantly expanded the jurisdiction and operational mandate of the Committee on Foreign Investment in the United States (CFIUS). The proposed rules will amend and restate the current CFIUS regulations at 31 CFR part 800 and will add a new part 802 covering certain real estate transactions.

In a previous alert, we analyzed the proposed revisions to part 800, which will significantly broaden CFIUS's authority to review certain non-controlling, non-passive foreign investments in U.S. technology, infrastructure, and data companies. This alert analyzes the proposed regulations under part 802, which will implement CFIUS's new authority under FIRRMA to review certain real estate transactions. Public comments on both sets of rules must be submitted by October 17, 2019. The final regulations will become effective no later than February 13, 2020. Treasury recently announced that it will host two public teleconference briefings on the proposed regulations this **Friday, September 27, 2019**, beginning at **10:00 a.m. (EDT)**.

New CFIUS Jurisdiction Over "Covered Real Estate Transactions"

Prior to the enactment of FIRRMA, CFIUS was limited to reviewing only transactions that could result in "control" of a U.S. business by a foreign person. FIRRMA significantly expanded CFIUS's jurisdiction to include (among other things) certain real estate transactions involving foreign persons. Specifically, FIRRMA authorized CFIUS to review

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transactions by foreign persons involving U.S. real estate that is either (1) located within, or will function as part of, an airport or maritime port, or (2) in close proximity to a U.S. military installation or another U.S. government facility or property that is sensitive for reasons relating to national security; could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility, or property; or could otherwise expose national security activities at such an installation, facility, or property to the risk of foreign surveillance. Although CFIUS had reviewed and even opposed a number of transactions involving real estate prior to the enactment of FIRRMA – such as the 2012 acquisition by China-owned Ralls Corporation of an interest in four wind farm project companies located near a restricted military airspace, which was later unwound pursuant to a presidential order of divestiture – the expansion of CFIUS’s jurisdiction under FIRRMA is significant because it allows CFIUS to review real estate transactions even where the transaction does not involve a foreign investment in a U.S. business.

The proposed rule would implement CFIUS’s new authority under FIRRMA by creating a new category of “covered real estate transactions” that would include any purchase or lease by, or concession to, a foreign person of any “covered real estate” (discussed in greater detail below) that affords the foreign person at least three of the following four property rights:

- The right to physically access the real estate;
- The right to exclude others from physical access to the real estate;
- The right to improve or develop the real estate; or
- The right to attach fixed or immovable structures or objects to the real estate.

Covered real estate transactions also include any “change in the rights that a foreign person has with respect to covered real estate in which the foreign person has an ownership or leasehold interest or concession arrangement” if that change could result in the foreign person having at least three of these property rights. A “concession” refers to “an arrangement, other than a purchase or lease, whereby a U.S. public entity grants a right to use real estate for the purpose of developing or operating infrastructure for an airport or maritime port.” Treasury is considering whether other types of concessions should be included in this definition, such as concessions relating to energy generation and oil and gas activities.

The proposed rule defines “covered real estate” to include real estate that is either (1) located within, or will function as part of, an airport or maritime port, or (2) located within a specified geographic range of certain military installations and other U.S. government facilities or properties that are sensitive for national security reasons. To assist parties in determining whether real estate falls within the latter category, the names and locations of the relevant military installations are listed in an appendix to the proposed rule. Although the proposed rule defines “covered real estate” to include real estate located within one mile of other unspecified U.S. government facilities or properties that are sensitive for national security reasons, the appendix does not currently list any such facilities or properties.

The applicable geographic ranges are as follows:

- Within one mile of any military installation or another facility or property of the U.S. government identified in part 1 or part 2 of the appendix;
- Within 100 miles of the military installations identified in part 2 of the appendix (applicable to Army combat training centers; major range and test facility base activities; and military ranges owned by the U.S. Navy or U.S. Air Force, or joint forces training centers located in certain states);
- Within the same county or other geographic area of the military installations identified in part 3 of the appendix (applicable to active Air Force ballistic missile fields); and
- Within 12 nautical miles seaward of the U.S. coastline for the military installations identified in part 4 of the appendix (applicable to U.S. Navy offshore range complexes and offshore operating areas).

Exceptions

As noted above, a foreign person must acquire at least three of the four property rights listed above with respect to the covered real estate in order for the transaction to qualify as a covered real estate transaction subject to the proposed regulations. Additionally, the proposed rule identifies a number of “excepted real estate transactions” that will not be treated as “covered real estate transactions” subject to part 802.

Investments by Certain Foreign Investors. Similar to the exception for “covered investments” under the proposed revisions to part 800, covered real estate transactions under part 802 will not include real estate transactions by “excepted real estate investors” that have close ties to “excepted real estate foreign states.” Excepted real estate foreign states will be identified by the Secretary of the Treasury, with the agreement of two-thirds of the voting members of CFIUS, upon a determination that a foreign state “has made significant progress toward establishing and effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security.” Treasury intends to publish an initial list of excepted real estate foreign states with the final rule and may delay certain eligibility requirements for two years “in order to provide the eligible foreign states time to enhance their foreign investment review processes and bilateral cooperation.”

The proposed rule defines an “excepted real estate investor” as a foreign person who is (1) a foreign national who is a national of one or more excepted real estate foreign states (and is not also a national of any foreign state that is not an excepted real estate foreign state); (2) a foreign government of an excepted real estate foreign state; or (3) a foreign entity that meets each of the following conditions with respect to itself and each of its parents:

- The entity is organized under the laws of an excepted real estate foreign state or the United States;
- The entity has its principal place of business in an excepted real estate foreign state or the United States;
- Each member or observer of the board of directors or similar body of the entity is a U.S. national or a national of one or more excepted real estate foreign states (and is not also a national of any foreign

state that is not an excepted real estate foreign state);

- Any foreign person that individually holds (or each foreign person that is part of a group of foreign persons that, in the aggregate, holds) a voting or economic interest of 5% or greater in the entity is (1) a foreign national who is a national of one or more excepted real estate foreign states (and is not also a national of any foreign state that is not an excepted real estate foreign state); (2) a foreign government of an excepted real estate foreign state; or (3) a foreign entity that is organized under the laws of an excepted real estate foreign state and has its principal place of business in an excepted real estate foreign state or in the United States; and
- The “minimum excepted ownership” of the entity is held, individually or in the aggregate, by one or more persons each of whom is (1) not a foreign person; (2) a foreign national who is a national of one or more excepted real estate foreign states (and is not also a national of any foreign state that is not an excepted real estate foreign state); (3) a foreign government of an excepted real estate foreign state; or (4) a foreign entity that is organized under the laws of an excepted real estate foreign state and has its principal place of business in an excepted real estate foreign state or in the United States.

Regarding the last condition, the proposed rule defines the “minimum excepted ownership” with respect to an entity whose equity securities are primarily traded on an exchange in an excepted real estate foreign state or the United States as “a majority of its voting interest, the right to a majority of its profits, and the right in the event of dissolution to a majority of its assets.” For all other entities, the applicable threshold for each of these is 90%.

In the event that an excepted real estate foreign investor fails to meet certain of these criteria in the three years following the completion date of a transaction, CFIUS may file an agency notice with respect to the transaction within one year following the completion date of the transaction, or up to three years afterwards in extraordinary circumstances. Additionally, regardless of whether a foreign person meets each of the conditions listed above, a foreign person will not be treated as an excepted real estate investor if the foreign person or any of its parents or subsidiaries has, in the previous five years, engaged in criminal conduct or violated any U.S. foreign investment, sanctions, or export control laws or is listed on the U.S. Department of Commerce Bureau of Industry and Security’s Unverified List or Entity List.

Real Estate in Urban Areas. Covered real estate transactions generally will not include transactions involving covered real estate located in an “urbanized area” or an “urban cluster,” as those terms are defined by the U.S. Census Bureau. Urban clusters include geographic areas with a population of at least 2,500 but less than 50,000, whereas urbanized areas include geographic areas with a population of at least 50,000. This exception will not apply if the covered real estate is located within (or will function as part of) an airport or maritime port or if the covered real estate is located within one mile of any military installation or another facility or property of the U.S. government identified in part 1 or part 2 of the appendix.

Single Housing Units. Covered real estate transactions will not include the purchase, lease, or concession of covered real estate that is a single housing unit, including fixtures and adjacent land provided that the land is incidental to the use of the real estate as a single housing unit. The proposed rule defines a “single housing

unit” as “a single family house, townhome, mobile home or trailer, apartment, group of rooms, or single room that is occupied as a separate living quarters, or, if vacant, is intended for occupancy as a separate living quarters.”

Retail Trade, Accommodation, and Food Service. Covered real estate transactions will not include airport and maritime port leases and concessions where the terms of the lease or concession “restrict use to retail trade, accommodation, or food service sector establishments.”

Office Space. Covered real estate transactions will not include the purchase or lease by, or concession to, a foreign person of commercial office space within a multi-unit commercial office building provided that the following two conditions are met upon completion of the transaction:

- The foreign person and its affiliates do not, in the aggregate, hold, lease, or have a concession with respect to commercial office space in the building that exceeds 10% of the total square footage of the commercial office space of the building; and
- The foreign person and its affiliates (each counted separately) do not represent more than 10% of the total number of tenants in the building.

American Indian and Alaska Native Lands. Covered real estate transactions will not include the purchase, lease, or concession of land that is either (1) owned by an Alaska Native village, Native group, or Native Corporation; or (2) held in trust by the United States for any of the foregoing entities or for American Indians, Indian tribes, or Alaska Natives.

Covered Transactions Subject to Part 800. Covered real estate transactions will not include “covered control transactions” or “covered investments” subject to part 800, even if the transaction also includes the purchase, lease, or concession of covered real estate. The proposed rule cautions that certain long-term leases and asset sales in particular may be considered covered transactions subject to part 800 depending on the facts and circumstances of the particular case. Because covered transactions involving real estate fall outside the scope of part 802, the geographic ranges for covered real estate listed above would not apply to limit CFIUS’s jurisdiction in such cases. The proposed rule advises that parties to covered transactions should file with CFIUS under part 800 rather than part 802, even if the transaction includes real estate.

Other Provisions

Declarations. As with covered transactions under the proposed revisions to part 800, the proposed rule would allow parties to a covered real estate transaction to submit short-form “declarations” in lieu of a more detailed written notice. CFIUS will review declarations within a 30-day assessment period (in contrast to the 45-day review period for notices), and CFIUS may invite the parties to a covered real estate transaction to attend a meeting with CFIUS staff to discuss and clarify any issues pertaining to the transaction as part of its review. In accordance with FIRRMA (and in contrast to certain other transactions involving technology, infrastructure, and data businesses under FIRRMA), the proposed rule does not impose any mandatory filing requirements with respect to any covered real estate transactions.

Finality of Action. As with covered transactions subject to part 800, the proposed rule includes a safe harbor provision pursuant to which, absent special circumstances, the President and CFIUS may not exercise authority over a covered real estate transaction if the parties have submitted a written notice or declaration and have been advised by CFIUS in writing that CFIUS has concluded all action under section 721 with respect to the transaction.

Filing Fees. As with the proposed rule for part 800, the proposed rule for part 802 does not address CFIUS's new authority under FIRRMA to assess and collect filing fees for covered real estate transactions that are submitted through a written notice. The proposed rule notes that Treasury is still considering how to implement this authority and that it will publish a separate proposed rule regarding filing fees at a later date. Under FIRRMA, filing fees may not exceed the lesser of \$300,000 or 1% of the value of the transaction.

Periodic Review and Revision. As with the proposed rule for part 800, Treasury anticipates that it will "periodically review, and as necessary, make changes to" the part 802 regulations.

Wiley Rein has an unparalleled ability to assist clients on investments that raise national security concerns. We have more than two decades of experience handling matters involving national security, including CFIUS, export controls, Team Telecom, and the Defense Counterintelligence and Security Agency (DCSA), and have counseled clients in transactions that involve nearly every industry sector subject to CFIUS review. Should you have any questions, please reach out to any of the attorneys listed on this alert.

Register here for Wiley Rein's upcoming National Security Webinar with Senior Public Policy Advisor Nova Daly and Partner Rick Sofield as they discuss changes to the new regulations and CFIUS process under FIRRMA, Team Telecom and other national security developments.