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Legal Guidance for 2020 CFIUS Real Estate Regulations

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Practices: Real Estate

OVERVIEW

On January 17, 2020, the Office of Investment Security of the U.S. Department of Treasury published its final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), which defines the jurisdiction and authority of the Committee of Foreign Investment in the United States (“CFIUS”) and modernizes CFIUS’s review process relating to certain transactions that fall under its jurisdiction. The final regulations became effective on February 13, 2020. CFIUS issued its regulations in two parts: (1) Provisions Pertaining to Certain Investments in the United States by Foreign Persons; and (2) Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States.

Part 2, Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate (31 C.F.R. part 802) (“Part 2”), creates new regulations that implement CFIUS’s new authority under FIRRMA to review a concession to, or a purchase or lease by, a foreign person of certain real estate in the United States.

This article will (1) describe the new regulations created by Part 2, and (2) present a hypothetical case study to illustrate whether a voluntary notice should be filed under Part 2.

NEW REGULATIONS

Before the enactment of FIRRMA, CFIUS’s review of real estate transactions was limited to those that were part of a merger, acquisition or takeover transaction that could have resulted in control by a foreign person of a U.S. business. Under FIRRMA, CFIUS’s jurisdiction extends to “covered real estate transactions,” regardless of whether such transactions are part of a larger deal. It is important to note that “covered real estate transactions” are subject only to voluntary review, not the mandatory declaration requirement imposed on other transactions under FIRRMA.

The term “covered real estate transaction” includes “any purchase or lease by, or concession to, a foreign person of covered real estate” that provides to such foreign person at least three of certain basic property rights, including the right of access, the right to exclude, the right to improve and the right to attach fixed structures to the property (see § 802.212 and § 802.233). FIRRMA § 802.211 defines “covered real estate” as that which:

- (a) Is located within, or will function as part of, a covered port; or

(b) Is located within:

- (1) Close proximity of any military installation described in § 802.227(b) to (o), or another facility or property of the U.S. Government, in each case as identified in the list at part 1 or part 2 of appendix A to this part;
- (2) The extended range of any military installation described in § 802.227(h), (k), or (m), as identified in the list at part 2 of appendix A to this part;
- (3) Any county or other geographic area identified in connection with any military installation described in § 802.227(a), as identified in the list at part 3 of appendix A to this part; or
- (4) Any part of a military installation described in § 802.227(p), as identified at part 4 of appendix A to this part, to the extent located within the limits of the territorial sea of the United States.

In its discussion of the FIRRMA rules, the Department of Treasury notes that, during the comment period, commenters supported the department's approach in drafting the proposed § 802.211 of identifying "covered real estate" in terms of specific sites and distances. To that end, FIRRMA defines "covered port" by reference to various lists maintained by the Department of Transportation and readily obtainable from its website. Additionally, Appendix A identifies specific sites and locations by reference to military installations, municipalities and counties. "Close proximity" is defined as the area that extends outward one mile from the boundary of the property or facility in question, and "extended range" means the area that extends 99 miles outward from the outer boundary of close proximity to such property or facility. The "territorial sea" of the United States extends 12 nautical miles from the country's shores. Thus, the determination whether a transaction involving a particular property is within a physical distance that could subject it to CFIUS review under FIRRMA can be made relatively easily by referring to the Department of Treasury's rules and lists. Furthermore, the Department of Treasury has made a web-based tool available to further assist the public in this regard. It can be found at the following ([link](#)).

There are, however, exceptions to CFIUS review, as set forth in FIRRMA § 802.216, which excepts certain transactions from the definition of "covered real estate transactions." Among these are:

- (a) A purchase or lease by, or concession to, an excepted real estate investor of covered real estate, or a change in rights of an excepted real estate investor with respect to covered real estate. ... (c) The purchase, lease, or concession of covered real estate that is within an urbanized area or urban cluster, except for real estate that is subject to paragraph (a) or (b)(1) of §802.211. ... (f) The purchase or lease by, or concession to, a foreign person of commercial space in a multi-unit building that is covered real estate, if, upon the completion of the transaction: (1) The foreign person and its affiliates do not, in the aggregate, hold, lease, or have a concession with respect to commercial space in such building that exceeds 10 percent of the total square footage of the commercial space of such building; and (2) The foreign person and its affiliates (each counted separately) do not represent more than 10 percent of the total number of tenants based on the number of ownership, lease and concession arrangements for commercial space in the building.

The terms “urban cluster” and “urbanized area” are defined by reference to the most recent U.S. Census. An “urban cluster” is an area that has at least 2,500, but fewer than 50,000 individuals, and an “urbanized area” is one that has at least 50,000 individuals. § 802.215 defines “excepted real estate investor,” and the reader is encouraged to review this section to determine whether it qualifies as such. As a threshold matter, a foreign entity must, among other things, be organized under the laws of an “excepted real estate foreign state” in order to be considered an “excepted real estate investor” under this section, and until February 13, 2022, the only “excepted real estate foreign states” are Australia, Canada and the United Kingdom of Great Britain and Northern Ireland.

ENFORCEMENT AND PENALTIES

Upon completion of its investigation, CFIUS can recommend to the President that any of a number of actions be taken in response to a particular transaction. The President can prohibit or suspend the transaction (see § 802.508(b)(1)). Additionally, CFIUS can impose an agreement or certain obligations on the parties to the transaction in order to mitigate the threat that such transaction poses to national security.

Importantly, FIRRMA directs CFIUS to impose a civil penalty of up to \$250,000 per violation on any person who submits a declaration or notice containing a material misstatement or omission or making a false certification (§ 802.901(a)).

CASE STUDY

Corporation A is a Japanese corporation with its principal place of business located in Tokyo, Japan. It’s considering leasing office space in Lompoc, California to support its operations in southern California. The lease would demise 7,500 square feet of space on the second floor of an 85,000 square foot office building (“Building”). Corporation A has negotiated a tenant improvement allowance of \$10,000 with the landlord (“Tenant Improvement Allowance”). After Corporation A has made certain improvements to the premises and provided the landlord with, among other things, mechanics’ lien waivers, the landlord will reimburse Corporation A for the cost of the work up to the Tenant Improvement Allowance. Corporation A wants to know whether the lease is subject to CFIUS review under FIRRMA.

Question 1: Is the transaction a “covered real estate transaction?”

Answer: Yes. FIRRMA § 802.212 defines “covered real estate transaction” to include “any purchase or lease by, or concession to, a foreign person of covered real estate” that provides to such foreign person at least three of certain basic property rights. Corporation A’s lease of the Lompoc office space would clearly constitute a “lease by ... a foreign person.” Furthermore, the proposed lease would grant to Corporation A at least the following three basic property rights identified in § 802.233: the right to access the property, the right to exclude others from accessing the property, and the right to improve the real estate.

Question 2: Does the premises constitute “covered real estate?”

Answer: Yes. The premises are not located within, and will not function as part of, a covered port, and are not located in close proximity (i.e., within 1 mile) of any U.S. Government facility identified in the list at part 1 or part 2 of appendix A attached to Part 802. However, the premises are located approximately 20 miles, which is

within the extended range (i.e., 100 miles), of the Vandenberg Air Force Base, which is listed in part 2 of Appendix A of Part 802. Therefore, the premises constitute “covered real estate” under § 802.211(b)(2).

Question 3: Is the transaction an “excepted real estate transaction” under § 802.216?

Answer: Yes. According to the 2010 U.S. Census, the population of Lompoc, California was approximately 42,000 in 2010, which makes Lompoc an “urban cluster” under FIRRMA. Therefore, Corporation A’s lease constitutes an “excepted real estate transaction” under Section 802.216(c). It is worth noting that, assuming there are at least nine other persons or entities leasing space in the Building, the transaction would also be excepted under Section 802.216(f), as Corporation A’s lease demises less than 10% of the commercial space in the Building and Corporation A would not represent more than 10 percent of the total number of tenants leasing commercial space in the Building.

Corporation A’s lease of the Lompoc, California premises is therefore excepted from CFIUS review under § 802.216(c) and §802.216(f).

CONCLUSION

The Department of Treasury recently published new regulations implementing CFIUS’s authority under FIRRMA to review a concession to, or a purchase or lease by, a foreign person of certain real estate in the United States. The transactions subject to the voluntary review process under the new regulations are those that concern “covered real estate,” which is defined by the proximity of such real estate to certain U.S. government installations. There are, however, exceptions to CFIUS review, including for transactions involving property in certain urban areas and transactions involving “excepted real estate investors.” CFIUS and the President have broad enforcement powers under FIRRMA, including the right to prohibit a transaction outright and the right to impose measures to mitigate the risk that a transaction poses to national security, and CFIUS is authorized to impose a civil penalty of up to \$250,000 per violation on any person who submits a declaration or notice containing a material misstatement or omission or making a false certification.