

VIEWPOINTS



FINANCE & INVESTMENT

What Will Be FIRRMA's Impact on Real Estate and Critical Infrastructure Transactions?

New FIRRMA regulations will have significant implications for real estate deals involving foreign investors.

Foreign investment in U.S. real estate and critical infrastructure will soon be impacted by new national security review requirements. In August 2018, President Trump signed a law that will have significant impact on leasing, refinancing and developing real estate in the United States. The Foreign Investment Risk Review Modernization Act (“FIRRMA”) significantly expands the authority and resources of the Committee on Foreign Investment in the United States (CFIUS) to review foreign direct investment FDI in companies and properties that are present in or provide goods or services to the United States. On October 10, 2018, the U.S. Treasury Department issued the initial set of FIRRMA regulations, focused on foreign investment in critical technologies . But FIRRMA also specifically targets real estate and critical infrastructure transactions. This article describes CFIUS’s impact on the real estate and critical infrastructure industry and recommends actions investors and companies can take to prepare for continued success in this new regulatory environment.

What is CFIUS?

CFIUS is an interagency U.S. government committee that reviews statutorily-defined “covered transactions” to identify and address any consequent national security risks. CFIUS reviews seek to balance the U.S.’ foundational commitment to maintaining a free and open investment environment with the need to protect national security.

A CFIUS review of a covered transaction involves a national security risk analysis to identify any potential threat to national security arising from the characteristics of the foreign investor or through the nature of the U.S. target and its assets, technologies or information. Where risks are identified, CFIUS works with the parties to determine whether the risks can be mitigated either through modifications to the deal or post-transaction controls. If CFIUS

determines that risks cannot be mitigated, the committee can recommend that the President block or, if already completed, unwind the transaction.

What is changing?

Increased national security concerns have prompted more rigorous CFIUS scrutiny in recent years, including required modification of deals and implementation of controls in real estate and critical infrastructure-related transactions. For example:

- In April 2018, CFIUS required China's COSCO Shipping Holdings Co. to commit to divesting interest in a Long Beach, Calif. port terminal as a condition to approval of the company's acquisition of Orient Overseas International Ltd., a Hong Kong-based company.
- HNA Group Co., a Chinese conglomerate, is reportedly under pressure from CFIUS in connection with a refinancing transaction to place its ownership interest in a midtown Manhattan building into a trust.
- In August 2018, China's Shenzhen Energy Group Ltd announced that it was dropping its bid to purchase three solar power facilities in California when CFIUS did not approve the deal.

These heightened national security concerns have culminated FIRRMA, statutory reform designed to increase the Committee's powers. Changes that are particularly relevant to real estate and critical infrastructure transactions include:

- **Scrutiny of non-controlling transactions**—Any investment or change in ownership rights in U.S. businesses involved in critical technology, critical infrastructure or the collection of sensitive data of U.S. persons, which gives a foreign person access to material non-public technical information, board rights or substantive decision-making

involvement, is now a covered transaction, even if the foreign investor does not acquire a controlling stake.

- **Scrutiny of real estate transactions**—Any purchase, lease, concession or other change in rights of a foreign person in real estate that is proximate to a U.S. government national security-sensitive installation is now a covered transaction.
- **Mandatory declarations**—CFIUS previously relied on a substantially voluntary notification system. Under FIRRMA, certain covered transactions--including those that involve the acquisition of a “substantial interest” by a foreign government (including sovereign wealth funds) in critical infrastructure, critical technology or sensitive U.S. data businesses--will require mandatory declaration, with steep fines to enforce compliance.
- **Evasion**—FIRRMA gives CFIUS authority over any transaction that is “designed or intended to evade or circumvent” CFIUS jurisdiction. The statute also expands CFIUS resources and responsibility to proactively identify and review covered transactions that the parties failed to submit to CFIUS review. When CFIUS identifies such transactions, it can order a mandatory notification, may assess fines up to the value of the deal and can unwind the transaction itself.
- **Mandatory mitigation plans**—FIRRMA mandates that any national security risk identified by CFIUS must be addressed by a formal mitigation plan. The statute also explicitly ratifies the use of independent third parties to monitor such mitigation plans .
- **Filing fees**—FIRRMA authorizes CFIUS to charge a filing fee of up to 1 percent of the transaction value or \$300,000, whichever is less.

What is the likely impact on the real estate/critical infrastructure industry?

As FIRRMA is implemented, CFIUS review will become a necessary hurdle for a substantial share of real estate and critical infrastructure transactions

involving non-passive FDI. This impact will extend beyond acquisitions to include refinancing, leases and concessions and changes in investor rights and information access. Any transactions relating to critical infrastructure, property proximate to U.S. government facilities (particularly including the U.S. Capital region, port facilities and facilities near sensitive U.S. national security installations, currently including the Trump Tower), sovereign wealth-provided FDI, and/or transactions involving FDI from special concern countries (particularly China and Russia) will attract scrutiny. Once CFIUS focuses on a transaction, there is increased likelihood that mitigation measures will be required to address possible risks. The upshot is that foreign investors may have to pay a premium to account for the increased friction, overhead and risk of CFIUS-covered transactions.

Conversely, the overall effect may be to actually drive down prices as foreign capital (particularly Chinese and Russian) is handicapped from full participation in the market by the increased levels of friction and risk consequent to CFIUS review.

What should you do?

If you sell, lease, refinance or develop real estate or critical infrastructure and the transactions involve foreign persons or financing, you should prepare for a more complex regulatory environment.

- How do I determine if my property deal could be subject to CFIUS review?
- What do I need to know about my investors to determine whether their involvement may impact the risk of CFIUS involvement or required mitigation?

- Are there practical things I can do to reduce the risk of CFIUS involvement or reduce the impact on the value of the deal if CFIUS does become involved?
- What are the practical steps and timelines for engaging with the regulatory process?

How do I price this into the deal?

Building a team of competent counsel and interdisciplinary experts who can help you answer these questions, understand the new CFIUS environment and deliberately set conditions for success at each stage of the CFIUS lifecycle may be essential to your business's future.

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