CADWALADER

REAL ESTATE FINANCE news and views

CFIUS Basics for Real Estate Lenders

October 28, 2020 | Issue No. 17

By **Melissa Hinkle**
Partner | Real Estate

By **Kevin Sholette**
Special Counsel | Real Estate

By **Keith Gerver**
Associate | White Collar Defense & Investigations

I. Introduction

President Trump's early August 2020 Executive Orders prohibiting transactions with ByteDance Ltd. ("ByteDance"), the Chinese owner of the popular social media app TikTok, and, separately, ordering the divestiture of ByteDance's U.S. business operations, have thrust the activities of a once-obscure Executive Branch interagency body – the Committee for Foreign Investment in the United States ("CFIUS") – into everyday conversation. CFIUS's increasingly high-profile status reflects its expanded jurisdiction and authority under the 2018 Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") and the Treasury Department's implementing regulations, which were made final earlier this year.[1] The scope of transactions that now may come under CFIUS review is much broader, including the commercial real estate space. Lenders who operate in this market should familiarize themselves with CFIUS, its authorities, and its considerations, especially as foreign investment begins to pick back up along with the overall economy.

II. What Is CFIUS?

CFIUS is an interagency executive branch body composed of key departments and agencies that serves the President in overseeing the national security implications of foreign direct investment in the United States economy. If a proposed transaction falls within CFIUS's scope of authority, the President has the discretion to suspend, block, or approve the transaction or to conditionally approve the transaction subject to negotiated mitigation measures. CFIUS also has the power to review transactions after the fact, and if it identifies issues for which it would have required mitigation, the President has the right to unwind the transaction post-closing.

III. What Do Commercial Real Estate Lenders Need to Know about CFIUS?

Although CFIUS always had the authority to review real estate transactions to the extent that they involved a foreign person obtaining control over a U.S. business, and such control could threaten U.S. national security,[2] FIRRMA expanded CFIUS's jurisdiction to explicitly capture certain real estate transactions involving the purchase, lease, or concession of certain real estate by a foreign person – "covered real estate transactions." Commercial real estate lenders should be aware, though, that there may be instances in which other "covered transactions" – known as "covered control transactions" and "covered investments" – could be implicated.

A. Covered Real Estate Transactions

FIRRMA expanded the scope of CFIUS's authority to review "covered real estate transactions," which are defined under FIRRMA as purchases, leases, or concessions to a foreign person of certain "covered real estate" that affords

the foreign person at least three of the following rights, whether or not exercised:

- The right to access the real estate;
- The right to exclude others from physically accessing 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.

Real estate lenders thus need to understand what constitutes “covered real estate” and who might be a “foreign person.”

Covered real estate is defined as real estate (a) related to certain identified ports or (b) located within a particular distance of certain military installations or identified U.S. government property. CFIUS regulations – and the CFIUS website – provide a list of the ports, installations, and government property. CFIUS also recently unveiled a map search tool that interested parties can use to determine whether a certain piece of real estate is located within proximity to one of the listed facilities.

A foreign person, for CFIUS purposes, means:

(1) Any foreign national, foreign government, or foreign entity;

(2) Any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity; or

(3) Any entity over which control is exercised or exercisable by a foreign person.

B. Covered Control Transactions

Commercial real estate lenders may find themselves involved in a “covered control transaction” to the extent that the transaction involves a “long-term lease or concession arrangement under which a lessee (or equivalent) makes substantially all business decisions concerning the operation of a leased entity (or equivalent), as if it were the owner” or if CFIUS’s national security concern stems from the real estate aspects of the purchase of a U.S. business.**[3]** In recent years, CFIUS has scrutinized covered control transactions due to the proximity of the U.S. business to sensitive government facilities or the nature of the real estate itself. Some notable examples include: (i) the 2012 review by CFIUS of the acquisition by Ralls Corp., a Chinese-owned entity, of a wind farm in Oregon located near a U.S. Navy base and the subsequent order by President Obama requiring Ralls to divest itself of ownership of the wind farm; (ii) the 2014 acquisition of the Waldorf Astoria Hotel in New York City by Anbang Insurance Group, a Chinese-insurance conglomerate, which was reviewed and ultimately approved by CFIUS; and (iii) the 2017 conditional approval by CFIUS of the acquisition by COSCO Shipping Holdings Co., Ltd., a Chinese shipping company, of the controlling interest in Hong Kong-based ocean container shipping company Orient Overseas International Ltd., which had a long-term concession for the operation of a container terminal in Long Beach, California.

C. Covered Investments in a TID U.S. Business

Under FIRRMA, CFIUS now has the authority to review certain non-controlling “covered investments” in U.S. businesses associated with Technology, Infrastructure and Data (a so-called “TID U.S. business”). A TID U.S. business is one which falls into one or more of the following categories:

(1) A U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies.

(2) A U.S. business that performs specified types of work on covered investment critical infrastructure.

(3) A U.S. business that maintains or collects, directly or indirectly, sensitive personal data of U.S. citizens.

Commercial real estate loans are less likely to be affected by covered investments, as commercial real estate developers, owners and operators would not typically constitute a TID U.S. business.

D. Exceptions and Safe Harbors

With respect to real estate transactions, the implementing regulations include several exceptions and/or safe harbors, including the following:

- ***Excepted Real Estate Investors***. Certain “excepted real estate investors” are exempt from CFIUS scrutiny. To qualify as an “excepted real estate investor,” an investor must have a substantial connection with an “excepted real estate foreign state” and satisfy certain other criteria. The “excepted real estate foreign states” are currently only Australia, Canada, and the United Kingdom; this list is not expected to expand any time soon.
- ***Urban Centers.*** Transactions involving real estate within an “urbanized area” or “urban cluster” (as defined by the U.S. Census Bureau) do not constitute covered real estate transactions, unless the real estate is within a covered port or within one mile of certain identified U.S. military installations.
- ***Commercial Office Space in Multi-Unit Commercial Buildings***. The purchase, lease, or concession of commercial office space in a multi-tenant commercial building is not a covered real estate transaction if the foreign person does not (a) hold more than 10% of the total square footage of commercial office space in the building; or (b) represent more than 10% of the total number of tenants for commercial space in the building.
- ***Securities Underwriter***. An acquisition of securities by a person acting as a securities underwriter in the ordinary course of business is not a covered real estate transaction.
- ***Loans***. The extension of a mortgage, loan, or similar financing arrangement by a foreign person for the purchase, lease, or concession of covered real estate is not itself a covered real estate transaction. However, a loan or mortgage may become a covered real estate transaction if (a) there is an imminent or actual default or other condition and (b) there is a significant possibility that a purchase or lease by, concession to, or a change in rights involving a foreign person may result from the default of other condition and that would constitute a covered real estate transaction.

E. Notification of Covered Transactions to CFIUS

Mandatory notice rules do not apply to covered real estate transactions. While the parties to a covered real estate transaction are not required to file a notice with CFIUS, CFIUS has the authority to review the transaction at any time, even after it has closed and the President has the power to unwind such transactions.

If the parties to a transaction believe that the transaction may constitute a covered transaction, then the parties may seek CFIUS approval by either (a) filing a voluntary long-form “notice” with CFIUS detailing the subject transaction or (b) filing a short-form “declaration” with CFIUS, which is a truncated version of the more lengthy voluntary notice. If CFIUS approves a notice or a declaration, then the transaction is exempt from any further scrutiny by CFIUS, except in certain limited circumstances.

F. Length of CFIUS Review

FIRRMA proscribes the following fixed time frames:

- ***Declarations***. If the review is triggered by a declaration, then CFIUS has 30 days to complete its entire review. If, during its review, CFIUS uncovers issues that it wants more information about, it can require the parties to submit a long form notice and start the notice process described below.
- ***Notices***. If the review is triggered by a notice filing, then CFIUS has 45 days to complete its first level “review.” If, during the review, CFIUS determines it needs additional time, then it is able to initiate an “investigation” that could last up to an additional 45 days. At any point during its investigation, CFIUS may refer the transaction to the President, at which point the President has 15 days to make a decision.

IV. Conclusion

Although historically very few real estate transactions have triggered any intervention by CFIUS, recent statutory and regulatory changes have greatly expanded the scope of CFIUS’s jurisdiction into this area. Commercial real estate lenders should be attuned to transactions in which foreign persons are acquiring control rights over real estate that is located close enough to certain ports, airports, military bases, or other sensitive sites such that their control over such property might pose a threat to U.S. national security interests. The risk to commercial real estate lenders is that they finance a transaction that later has to be unwound. Consequently, as part of its due diligence process on any loan where there is a foreign person who has direct or indirect control rights over the borrower or the property, commercial real estate lenders should make sure to confirm that either (a) the property is not covered real estate that would fall within CFIUS’s jurisdiction; (b) the transaction is not otherwise a covered transaction; or (c) CFIUS has already reviewed the transaction and provided a safe harbor letter to the parties evidencing its approval of the transaction.

[1] See, e.g., Keith Gerver's February 13, 2020 Clients & Friends Memorandum, entitled "**Final Regulations on Expanded Authority of CFIUS to Review Foreign Investor Transactions Go into Effect**."

[2] See 31 C.F.R. § 800.210 (definition of covered control transaction) and 31 C.F.R. § 800.208 (definition of control).

[3] See 31 C.F.R. § 800.249.