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A Tilt of the Globe

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Outlook on Foreign Investment in U.S. Commercial Real Estate

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Foreign investment in U.S. commercial real estate has dramatically increased over the past several years. Foreign investors have long viewed the United States — in particular, trophy assets and other properties in cosmopolitan markets in California, New York and Miami — as a safe place to park their money while seeking steady returns. However, in the first half of this year, we have seen a sharp decline in the amount of foreign investment in U.S. commercial real estate, in particular, by Chinese investors. For the first time in seven years, foreign investors in U.S. commercial properties, including office buildings and retail space, sold more than they bought, with purchases of these properties totaling $21.3 billion and sales totaling $21.4 billion.

While the drop may be due in part to some large acquisitions that closed last year, there are several additional factors that may account for such a plunge. Fears of an impending recession and uncertainty over U.S. interest rates have made buyers more cautious, and the stronger U.S. dollar has made purchasing U.S. properties more expensive. In addition, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) significantly expanded the authority of the Committee on Foreign Investment in the United States (CFIUS) to review foreign direct investment in certain properties and may have chilling effects on the purchase of real estate by foreign investors. Any purchase, lease, concession or other change in the rights of a foreign person in real estate that is proximate to a U.S. government national security-sensitive installation is subject to the review and scrutiny of CFIUS. If risks are identified by CFIUS, there may be ways to mitigate the risks through modifications to the transaction or post-transaction controls. However, if CFIUS determines that such risks cannot be mitigated, CFIUS may recommend that the U.S. President block or, if the transaction is closed, unwind the transaction. Such expanded and heightened scrutiny may curtail foreign investment in U.S. projects and properties as such investments become more difficult and more expensive.

Changes to the EB-5 investments program, which take effect on November 21, 2019, also are likely to impact foreign investment. The EB-5 program offers a way for foreign citizens to obtain green cards by investing in qualifying real estate projects. The new rules taking effect at the end of the year will increase the minimum investment required under the program for targeted employment areas from $500,000 to $900,000, and the U.S. Citizenship and Immigration Services (USCIS) now will directly review and determine the designations of high-unemployment targeted employment areas ("TEAs") rather than deferring to TEA designations made by state and local governments. These changes, along with increasing the investment requirement for projects outside of the TEAs from $1 million to $1.8 million, are likely to reduce the number of foreign investors making investments in real estate through the program.

In prior years, approximately 85% of the EB-5 green cards were issued to Chinese nationals, but that percentage has dropped recently since the wait times for Chinese investors for EB-5 green cards can be more than 10 to 15 years. But additional factors also have resulted in investment from Chinese investors, one of the biggest purchasers of U.S. commercial real estate in recent years, to drop dramatically in the past year. Recent trade disputes between the United States and China over tariffs could have more far-reaching effects. In the past, some of the biggest commercial real estate deals, including the purchase of 245 Park Avenue by HNA Group for $2.21 billion in 2017 and Anbang Insurance Group's acquisition of the Waldorf Astoria in New York City in 2014 for $1.95 billion, had Chinese buyers. There has been a retreat by Chinese investors in commercial real estate recently, in part due to China's capital controls on outbound investments. In addition, when the Chinese yuan fell to an 11-year low, the Chinese government placed additional capital restrictions on taking money out of China and investing in real estate overseas.

Despite the decline by Chinese and other foreign investors in the first half of this year, foreign investors will likely continue to invest in U.S. commercial real estate, although the form of such investment may change. Certain foreign money managers have been putting their money into stocks and bonds of REITS and real estate companies. Other investors have chosen to structure their investments in the form of debt rather than equity, which they view as a safer bet in the event of a recession. South Korean institutional investors have been particularly active in the purchase of real estate debt, accounting for approximately 21% of all foreign investment in U.S. real estate debt. The recent drop in interest rates, resulting in lower hedging costs, may be enough to spur continued foreign investment, and U.S. real estate still offers the potential for higher returns compared to the rates of return in London and parts of Asia. While recent financial market volatility may make investors more cautious, the U.S. economy continues to be growing faster than most other global economies, and the U.S. commercial real estate market is still the largest and most liquid real estate market in the world.

Private Placements as an Alternative Financing Tool in the European Real Estate Market

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The U.S. real estate industry has long benefited from an active private placement market, where companies can raise financing by offering directly to investors the opportunity to invest in them. However, it is only over the last decade that we have witnessed the use of private placements in Europe as a legitimate competitor to the more traditional bond market.

In this article, we give an overview of private placements and their place in the European real estate debt market, outlining some of the advantages and issues when considering a private placement in Europe.

What are private placements?

A private placement is a form of unregistered securities offering in which there is a placement of debt by way of an offer and sale of securities (usually in the form of bonds or notes or a loan).

Most private placements consist of medium- to long-term financings, which are negotiated between a small or specific group of investors and the issuer.

Private placements in Europe

Private placements do not involve a public offering; as such, it is essentially illiquid (though is transferable and may be listed if required to satisfy certain investor criteria). This naturally encourages greater protections to be afforded to investors than what otherwise would be found in the bond market, such as more extensive events of defaults and change of control provisions.

We are also now seeing increasingly more financial covenants (such as leverage ratio, interest cover ratio and/or gearing ratio, in addition to the more traditional "loan-to-value" covenant that has become the norm in European real estate financings), more extensive negative pledge provisions that cover all indebtedness of the borrower, wider general covenants (such as broader limitations on disposal of assets and incurrence of new/further indebtedness) and the requirement to be ranked *pari passu* with other lenders of the borrower.

With that said, such protections ultimately are tailored to the circumstances and structure of the issuer, which, in the case of real estate private placements, is often a special purpose financing vehicle of the parent business, wrapped in a ring-fenced limited recourse structure with no parent guarantees, allowing the business to isolate the collateral pool to certain properties/portfolio of properties.

The advantages of a private placement

There are a number of key advantages for a real estate business to pursue private placements as a tool for financing.

Timing: There is usually little or no requirement to prepare any extensive formal documents that require approval by a governing body, as well as any ongoing public disclosure and reporting requirements that often accompany public offerings. Furthermore, it is often the case that private placement bonds do not require credit agency rating. As such, the time-to-market time frame for private placements is often much shorter than a traditional public offering.

Cost: With substantially lower disclosure requirements and regulatory hurdles to overcome, set-up costs can be significantly lower than for listed or publicly offered securities or syndicated loans, as well as ongoing costs. There is also typically no commitment fee, and the coupon is usually fixed.

Long-term investors: Private placements generally attract a broader range of investors, including buy-to-hold investors who seek a long-term relationship with the company, such as insurance companies, funds and asset managers.

Confidentiality: Private placements are not offered to the public but are made directly with the investors. As such, the company will not be subject to any extensive disclosure requirements, and the company's business, financial information and other affairs will be disclosed only to a small, focused group of investors.

Flexibility and independence: From structuring it as a loan or securities to the choice of investors, each private placement may be tailored to the requirements of the company, providing greater flexibility to both the issuer and investors to meet all parties' financial needs. Furthermore, as there is direct contact between the issuer and the investors, it is easier for the requirements of the investors to be negotiated in order to provide a truly tailored investment product.

Documentation in European private placements

Private placements generally are negotiated directly between the issuer and the investors, together with the participation of an arranger, and it will be agreed from the outset what form of documents the private placement shall be taking.

U.S. ACIC Model form documents are still used in European private placements, but in 2015 the LMA launched a suite of template documents for private placements that, since their launch, have been the more popular choice. The LMA templates include a loan agreement that is also capable of being evidenced as a note and is based on the existing LMA investment grade term facility agreement; so, for many parties, they provide comfort, certainty and familiarity.

The template documents also provide a precedent subscription agreement, term sheet and confidentiality agreement, and, to the extent that security is provided, the traditional suite of LMA security documents may be used as the starting point. Most significantly, such templates can very readily and easily be adapted to other governing laws and market sectors across Europe and can be tailored to a whole range of borrowers and issuers within the real estate industry.

Conclusion: The future for private placements for European real estate businesses and investors

Private placements offer a great alternative to the existing plethora of financing tools that are already dominant in the European debt market, and the increase over the years in new private placements, as well as the increasing number of U.S. investors investing into such European private placements, are further illustrations of this.

It can be a cheaper and more efficient product to launch and can provide the level of flexibility that a growing business requires, as well as attract the institutional investors that value buy-to-hold investments for their financing needs. Anchored by the increased use of LMA-standardised templates for European private placements, European issuers can have greater confidence in the structures and covenants that they are signing up to, without having to look overseas to how they do it in the United States.

What the New 'Mansion' Tax Increase Means for New York's Residential Real Estate Market

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Question: What is the New York Mansion Tax?

Answer: In 1989, Governor Mario Cuomo instituted New York Consolidated Laws, Tax Law § 1402-a, which imposed a 1% tax on sales of residential properties for $1,000,000 or more across the State of New York. In April 2019, lawmakers enacted the state's 2019-2020 budget, which included a new tax bracket for New York City properties sold for more than $1,000,000. This new tax increase became effective on July 1, 2019.

Q: What is changing?

A: The mansion tax increased from a 1% surcharge on any residential properties sold for over $1,000,000 to a tiered bracket applicable to New York City properties as follows:

Purchase Price	**Mansion Tax Rate**
$1,000,000 – $1,999,999	1.00%
$2,000,000 – $2,999,999	1.25%
$3,000,000 – $4,999,999	1.50%
$5,000,000 – $9,999,999	2.25%
$10,000,000 – $14,999,999	3.25%
$15,000,000 – $19,999,999	3.50%
$20,000,000 - $24,999,999	3.75%
$25,000,000 or more	3.90%

For example, a home that sells for $2,250,000 will be subject to a tax of $28,125 rather than $22,500. The difference in taxes owed for the most lavish properties, however, could be as significant as $725,000 for a $25,000,000 property, revitalizing the meaning of the name "mansion" tax. This tax is separate and apart from the New York City Transfer Tax, which will remain at 1% for sale prices of $500,000 or less and 1.425% for any sale over $500,000. The transfer tax is the seller's burden, while the mansion tax is the purchaser's burden.

Q: Why is this coming up now?

A: This increase, which applies only to properties sold in New York City, was largely a response to recent record-breaking deals in the city's residential real estate market. Most notably, Ken Griffin's approximately $240 million purchase at 220 Central Park South — the most expensive home ever sold in the United States — inspired lawmakers to draft the first revision to the New York Mansion Tax in 30 years. The increase has been enacted to help improve the city's subway system, after the governor's plan to tax marijuana sales fell short.

Q: Who will this most likely affect?

A: Experts are divided on how the new tax increase will affect the real estate market. Most agree, however, that although it will take some time for the market to adjust, this will not have a chilling effect on luxury sales in the long term. Others say that, given the current buyer’s market, even though the mansion tax is the buyer’s burden, sellers and developers will feel the brunt of this tax the most and will have to adjust pricing accordingly in order to accommodate the increase.

Recent Matters

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Here is a rundown of some of Cadwalader's recent work on behalf of clients:

- Represented the lenders in the $1.2 billion financing of Century Plaza Towers in Los Angeles.
- Advised the lenders on a $350 million mortgage loan secured by 11 single-tenant industrial properties located in various states.
- Advised the administrative agent and lender in a $1.55 billion syndicated mortgage loan to finance the acquisition of approximately 140 industrial properties as part of the acquisition of the Global Logistics Properties portfolio.
- Served as counsel to the lender in a $415 million mortgage loan secured by a portfolio of 10 multifamily projects located in California, Washington and Arizona.
- Advised the lenders in the $525 million financing of a recently developed office complex in Washington, D.C.