

Understanding CFIUS

New rules mean foreign investments in U.S. real estate fall under government review

INTERVIEWED BY SUE OSTROWSKI

The rules of international investment in U.S. real estate have changed, and failure to understand these new rules — issued by the Committee on Foreign Investments in the United States (CFIUS) in February — could cause huge headaches.

“If you’re not aware of or don’t understand the rules, that could cause a real estate deal to be undone by CFIUS, potentially resulting in financial harm or making a business liable to a foreign entity,” says Boyd A. Stephenson, an attorney at Babst Calland.

The president has the authority to reverse certain business transactions involving a foreign entity if it is determined they pose a national security risk. CFIUS advises the president on when to do that. In February 2020, that authority was extended to real estate ownership.

Smart Business spoke with Stephenson about the impact of the new rules.

WHAT IS CFIUS, AND HOW DOES IT WORK?

CFIUS is an interagency committee of the federal government that advises the president about mergers and acquisitions, financings, and real estate transactions that involve foreign actors. If a foreign entity wants to invest in or buy a cardboard box manufacturer, it’s generally not a concern. But if it wants to invest in a U.S. startup that’s developing technology with better AI, such an investment would result in a review from CFIUS to determine whether the deal should be cancelled based on national security concerns. This authority is retroactive, so if your deal consummates on April 15 and the transaction is reversed on May 1, you lose that equity stake.

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HOW DOES THE NEW RULE EXTEND INTO REAL ESTATE TRANSACTIONS?

The new rule applies to real estate acquisitions that are a certain distance from an airport or seaport, or, for a military installation, up to being within the same county. You need to be aware of the rules, because if you are selling property to a foreign entity, you want to make sure that transaction can be completed. The last thing you want is to go through the negotiating process and have a transaction called back because of a ruling by CFIUS.

For most transactions, companies can submit a five-page declaration with the government, identifying who they are and who the foreign investor is and describing terms of the deal. CFIUS will either say it’s good to go, or it’s not happening, or initiate a notice process, which is a significantly longer filing for transactions that attract scrutiny. Transactions that involve an entity from Canada, Australia or the United Kingdom are exempted from this rule.

WHAT ARE THE DANGERS OF BEING UNAWARE OF THE NEW RULE?

The worst-case scenario would be to close a sale of real estate to a foreign entity, only to find out later that the transaction fell within the scope of the rules and should have been reviewed, then have the government force you, as the seller,

to undo the transaction. The risks and potential liability to the seller, both from having to walk back the sale and potential claims by the foreign investor buyer, are substantial.

From the perspective of the seller, it can be dangerous to sell to a foreign entity without a thorough review of the CFIUS rules to determine if they apply, and if there is any question, a review and recommendation by the committee. It is a good idea to address the potential outcomes of a CFIUS ruling in your real estate sales agreement to protect both parties.

HOW DO YOU KNOW IF YOUR TRANSACTION WITH A FOREIGN ENTITY REQUIRES REVIEW?

At a minimum, any transaction involving a foreign investor should include an analysis by legal counsel of the risks and applicability of the rules. For CFIUS review, even an American buyer with a minor stake held by a foreign entity could be treated as a foreign entity. The good news is that the transactions likely to attract scrutiny are pretty common sense. If you are a box company, it’s probably not an issue, unless you are located next to a military installation. But if you are a cutting-edge data processing firm, doing AI, lasers or technology, you should be aware of the rules. If not, this is an area where ignorance could really come back and bite you. ●