

Foreign Investment Restrictions in US Real Estate: Recent Developments and Takeaways



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Following what many viewed as a jarring determination by the Committee on Foreign Investment in the United States (CFIUS) that it did not have the legal authority to review a Chinese-owned company's acquisition of land in North Dakota, the national security implications of real estate transactions have become the subject of increasing attention in Congress as well as in state and local governments.

CFIUS is an interagency committee of the US government chaired by the US Department of the Treasury. Established by Executive Order in 1975, CFIUS has long had the legal authority to review control transactions involving "foreign persons" and "US businesses." In 2018, the Foreign Investment Risk Review Modernization Act expanded CFIUS's jurisdiction to cover certain real estate transactions (e.g., greenfield land acquisitions) involving "foreign persons" (e.g., foreign investors and, in certain cases, foreign limited partners investing indirectly through US-controlled funds) to assess, and if warranted, impose measures to address any national security risks arising from underlying transactions.

The acquisition of land in North Dakota by the US subsidiary of the China-based Fufeng Group Limited demonstrates that, although CFIUS's legal authority is broad, it is not infinite. In this connection, following CFIUS's Fufeng decision and based on perceived gaps in CFIUS's jurisdiction, members of Congress and various state and local legislators—with China clearly in their sights—have increasingly called for new and different restrictions to address perceived national security risks arising from non-US investment in US land.

As a result, real estate investors considering transactions must now contend with questions of CFIUS's jurisdiction

and the advisability of making a CFIUS filing, as well as whether potential changes to CFIUS and/or future state-level restrictions may change the regulatory risk calculus for an investment. We provide below a summary of the CFIUS process, the Fufeng case, and proposed and current regulatory mechanisms that may affect foreign investment in US real estate. Finally, we offer certain key takeaways for investors navigating regulatory uncertainty in the current environment.

The CFIUS Process

CFIUS has the jurisdiction to review certain transactions by foreign persons involving a US business (i.e., "covered transactions") and US real estate even if there is no underlying US business (i.e., "covered real estate transactions"). Whether a transaction qualifies as a covered real estate transaction depends on (1) the proximity of a parcel of land to one of the listed sensitive military or government sites in the CFIUS regulations and (2) the acquisition by a foreign person of at least three of the following rights with respect to the underlying land (whether or not these rights are, in fact, 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*
- *The right to attach fixed or immovable structures or objects to the real estate*

To date, transaction parties have notified relatively few covered real estate transactions to CFIUS. In calendar year 2021 (the most recent year for which data are publicly available), CFIUS reviewed only seven filings for covered real estate transactions (versus more than 400 filings for all covered transactions). This may be, in part, because CFIUS considers many transactions that investors consider traditional real estate transactions (e.g., the acquisition of a planned multifamily housing development for which construction has yet to commence) to be acquisitions of existing US businesses and thus evaluates them under a different standard and does not report them as real



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estate deals. It may also be because, unlike for covered transactions, CFIUS does not legally require filings for any covered real estate transactions, and real estate investors either are not aware of the CFIUS process or decide not to make voluntary filings for specific transactions that might be of interest to CFIUS.

The Fufeng Decision

In November 2021, Fufeng, a Chinese-owned manufacturer of bio-fermentation products, announced that it had selected 370 acres of land in Grand Forks, ND, for a new wet corn mill. The land was just 12 miles from the Grand Forks Air Force Base, which prompted bipartisan calls from members of Congress for CFIUS to review Fufeng's acquisition of the land and a request from the city of Grand Forks for Fufeng to make a voluntary filing with CFIUS for the acquisition. Calls for CFIUS review were generally based on concerns that the Chinese government, acting through Fufeng, would be able to conduct covert surveillance of the Grand Forks Air Force Base, which hosts a US military drone facility and new space networking center. Sen. Mark Warner (D-VA), chair of the Senate Intelligence Committee, stated that Chinese acquisitions of land close to sensitive US government sites pose a serious "counterintelligence threat." After it reviewed the transaction, CFIUS determined in Nov. 2022 that it lacked legal authority to review the transaction. As a result, CFIUS could not impose conditions on Fufeng's purchase of the land or recommend to President Joe Biden that he prohibit the acquisition; the US federal government was effectively without tools to address perceived national security risks arising from the deal.

CFIUS's decision to decline jurisdiction over the transaction stunned lawmakers. Sen. Marco Rubio (R-FL) condemned the outcome as "dangerous and dumb." Sen. Kevin Cramer (R-ND) characterized it as "underwhelming" and "disappointing," stating that he believed the project presented "serious concerns." And South Dakota Gov. Kristi Noem (R) called for legislation to create a state-level CFIUS equivalent to review Chinese acquisitions of agricultural land in South Dakota.

Following CFIUS's decision, the US Air Force briefed local authorities about its national security concerns regarding the Fufeng project. The assistant secretary of the Air Force also released a letter to North Dakota's senators, which stated, in pertinent part, that Fufeng's "proposed project presents a significant threat to national security with both near- and long-term risks of significant impacts to our operations in the area." The Air Force's efforts were apparently persuasive: the Grand Forks City Council decided to deny Fufeng the permits it would need for the construction and development of its project, and the project does not appear likely to proceed.

Trends in Proposed Legislation

The Fufeng decision prompted a number of states to reconsider existing regulations pertaining to foreign investment in land and to push forward new proposals to address what they perceive as gaps in CFIUS's jurisdiction. To date, more than nine bills have been introduced in the 118th Congress aimed at addressing foreign investment in agricultural land, including several that would add the US Department of Agriculture as a statutory member agency to CFIUS, prohibit persons affiliated with the Chinese Communist Party from acquiring US agricultural land, and enhance reporting requirements for foreign investors investing in US agriculture.

More than 20 states, primarily those in which agriculture is a prominent industry, have recently proposed or enacted legislation addressing foreign investment in real estate. This legislation ranges from a complete ban on any foreign entity acquisitions of certain agricultural land (Indiana) to a prohibition on Chinese acquisitions of agricultural land (Arkansas) to the creation of a state-level CFIUS analogue (South Dakota).

State-level bills, both proposed and enacted, vary greatly with respect to the types of restrictions that a bill would impose, as well as the prospective “foreign” party on which such restrictions would be imposed. For example, proposed legislation in South Carolina would restrict acquisitions of land by any company that is owned, in whole or in part, by a company with its principal place of business in China, whereas proposed legislation in Arkansas would regulate acquisitions by entities headquartered in China or entities directly or indirectly held or controlled by the government of China. Although the Arkansas proposal appears unlikely to capture a minority, indirect investment in real estate by a Chinese government-controlled limited partner, the South Carolina proposal could be read to regulate such an interest in the reference to “partial” ownership, particularly as it does not carve out any de minimis threshold for partial ownership. However, some states have begun to build out these definitions to contemplate private equity structures: other proposed legislation in South Carolina sets threshold limits for ownership interests of Chinese investors at 10% for a single shareholder and 20% for aggregated ownership interests, and recently passed legislation in Florida carves out noncontrolling interests in US entities that are controlled by entities registered with the US Securities and Exchange Commission as investment advisors. Nevertheless, even where proposed legislation offers more specific definitions, such as in Washington State (where, like South Carolina, proposed legislation specifically provides for a threshold foreign ownership/control interest, which would trigger restrictions), material gaps remain as to the application of these provisions to more complex structures. Notably, in a number of bills, it is unclear whether interests held by multiple foreign investors or limited partners should be aggregated to reach the relevant threshold or if definitions would capture only single investors or limited partners that, individually or as a group under common control, hold an interest of a particular size. Moreover, some states have also begun adopting new reporting mechanisms to track foreign investment in real estate as a supplement to federal reporting requirements under the Agricultural Foreign Investment Disclosure Act.

Key Takeaways for Investors

- Foreign investment in US real estate will remain a target for political and regulatory scrutiny, at least in the near term. The uptick in proposed legislation on the federal, state, and local levels should be viewed as a harbinger that bipartisan momentum is behind efforts to increase regulation of foreign investment in US land.
- State-level bills vary greatly in how they define “foreign” investment and thus in how they might act to regulate or restrict such investment. In their current form, most bills do not appear to regulate or require disclosure for traditional private equity structures in which passive foreign limited partners may hold interests in US real estate, and those that do, have significant variations such that the same entities could potentially trigger substantially different restrictions—or none at all—depending on the state in which they are investing. That said, this gap would appear fairly easy to close, and investors should carefully assess the likelihood that current and future transactions may warrant a CFIUS filing or trigger state-level restrictions.
- State legislators increasingly view themselves as having agency to act to protect US national security interests and are actively taking steps to address what they perceive to be gaps in CFIUS’s power to review real estate investments. With numerous bills pending in state legislatures and the implementation of enacted bills, there is the potential for an ad hoc investment landscape in which investors considering a deal involving a portfolio of assets in multiple states may face complex regulatory considerations and/or disclosure requirements.
- Investors should not assume that ambiguous state-level restrictions may enable them to avoid regulatory intervention with respect to a perceived national security issue. States and municipalities have been aggressive in using state permitting and other mechanisms as a backstop to encourage parties to make CFIUS filings and/or, in the extreme case, frustrate a transaction. ■

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