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CFIUS's Proposed Regulations to Implement Expanded Jurisdiction Over Real Estate Transactions

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Introduction

As we reported previously, last week the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") issued its proposed final regulations ("Regulations") to implement its expanded authorities under the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). In doing so, CFIUS bifurcated the rulemaking process, proposing one set of regulations to govern the CFIUS process generally, and separate regulations implementing its new, expanded jurisdiction to address certain transactions involving the purchase by, lease by, or concession to, a foreign person of certain real estate in the United States. In this separate alert, we address the particular considerations associated with CFIUS's rulemaking to implement the real estate aspects of FIRRMA.

Prior to FIRRMA, CFIUS had authority to review acquisitions of real estate only where such acquisition occurred in the context of the transfer of control of a U.S. business to a foreign person. Acquisitions of undeveloped or non-commercial real estate were not subject to CFIUS review. Now such "greenfield" transactions will be subject to CFIUS jurisdiction if they satisfy the criteria set forth in the Regulations.

Importantly, the Regulations tether CFIUS's new authority to specific locations — air and maritime ports and U.S. military and government facilities listed in a four-part appendix to the Regulations — and graduated proximity ranges corresponding to the level of vulnerability of those military and government facilities and related operations to surveillance. The Regulations also carve out certain exceptions to CFIUS's jurisdiction within the different proximity ranges for single-housing units, commercial office spaces, and densely populated areas, among others.

The Regulations for real estate transactions are complex and technical, introducing new authorities and exceptions, key defined terms, and the appendix listing relevant U.S. military and government installations, facilities, and operating areas to help illuminate the scope of CFIUS authority to review what the Committee has defined as "covered real estate transactions." We expect the Regulations to present issues of first impression and interpretation that will require transaction parties working with counsel to conduct a detailed analysis to determine whether a real estate transaction falls within the scope of CFIUS's new authority.

Comments on the Regulations are due October 17, 2019. This will be the only formal opportunity for transaction parties and other interested stakeholders and members of the public to help shape the final regulations that will control the new CFIUS process. We want to underscore that such comments will be critically important in establishing the framework that will govern CFIUS's authorities over real estate transactions going forward. This is particularly so here, where CFIUS's authority is brand new, and comments will establish an administrative record against which the final regulations can be understood and assessed. The final regulations are expected to be issued in January 2020, 30 days before they become effective in February 2020.

Discussion – Key Questions and Answers

With that introduction, we answer key questions related to the real estate provisions of the Regulations:

1. What new authority is CFIUS implementing through the real estate regulations?

As background, the Department of Defense ("DoD"), and to a lesser extent, other U.S. government agencies, including the Departments of Homeland Security, Justice, and Energy, have long used the CFIUS process to review perceived risks related to acquisitions of U.S. real estate by foreign persons that could facilitate privileged, persistent, and inconspicuous observation of those agencies' facilities and operating areas, particularly as those risks related to operational deployments, training activities, and military testing. However, CFIUS historically could review real estate acquisitions only in cases where such real estate was an asset of an existing U.S. business, control of which concurrently was being acquired by a foreign person. By way of example, CFIUS had the ability to review the foreign acquisition of a warehouse property immediately adjacent to a sensitive military installation when the property was included in the acquisition of a controlling interest in an existing U.S. business. However, CFIUS could not review the acquisition of that exact same property if it was only undeveloped, unimproved land.

Congress accordingly included additional authorities in FIRRMA that would allow the Committee, for the first time, to review greenfield investments in U.S. real estate. Specifically, FIRRMA permits CFIUS to review the purchase or lease by, or a concession to, a foreign person of private or public real estate that is located in the United States and: (a) is located within, or will function as part of, an air or maritime port; (b) is in close proximity to a U.S. military installation or another facility or property of the U.S. government that is sensitive for reasons relating to national security; (c) could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility, or property; or (d) otherwise could expose national security activities at such an installation, facility, or property to the risk of foreign surveillance.

FIRRMA does not define what constitutes "close proximity" in this context, but charged the Committee, when developing the Regulations, to ensure that the term refers only to a distance or distances within which the purchase, lease, or concession of real estate could pose a national security risk. As discussed below, in response to this charge, the Regulations identify specific military installations and other U.S. facilities and property, together with proximity ranges, as the basis for CFIUS jurisdiction. Further, the Regulations provide certain exceptions to this authority, which we also address below.

2. What does "proximity" mean?

In defining "close proximity," the Regulations introduce two new important definitions — one which provides clarity with respect to "close proximity," and the other which adds to the proximity analysis the "extended range" — for investments that could provide a foreign person the ability to collect intelligence or otherwise expose national security-related activities to the risk of foreign surveillance.

Specifically, the Regulations define "close proximity" as the area extending one mile outward from the outer boundary of certain U.S. military installations or other U.S. government facilities or property. Specific military installations and U.S. government properties are identified by reference to parts 1 and 2 of the appendix to the Regulations and include certain U.S. Air Force, Navy, Marine Corps, Army, and joint service installations; DoD office buildings in the Washington, DC area, including the Pentagon; major military testing and training ranges and related facilities; offices for military research laboratories such as the Defense Advanced Research Projects Agency; radar and tracking sites; and manufacturing depots and arsenals.

The Regulations moreover define the "extended range" as the area that further extends 99 miles outward from the outer boundary of close proximity to those U.S. government facilities listed in part 2 of the appendix. In effect, this creates a 100-mile net radius for real estate purchases, leases, or concessions around these specific military installations. While not expressly discussed in the Regulations, these installations generally are connected with particularly sensitive U.S. military sites, with active training, and testing operations such as large-scale military training maneuvers, space operations (including anti-ballistic missile sites), and testing centers for advanced weapons platforms and technologies. There is an exception to this "extended range" in that it does not apply beyond 12 nautical miles seaward of any U.S. coastline, as this crosses into international waters.

The Regulations also indicate that the Committee has jurisdiction to review real estate transactions that occur within the counties or other geographic areas identified in part 3 of the appendix, which surround active U.S. Air Force ballistic missile fields and related installations, as well as those within 12 nautical miles of various U.S. Navy off-shore range complexes and off-shore operating areas identified in part 4 of the appendix.

The Regulations provide examples detailing how these terms are implemented and how their application is limited to covered *real estate* transactions, rather than covered U.S. business transactions under CFIUS's traditional jurisdiction. As one such example, where Corporation A, a foreign person, wholly acquires Corporation X, a U.S. business that owns and leases real estate in close proximity to a military installation identified in part 1 or part 2 of Appendix A, the acquisition is *not* a covered real estate transaction subject to the Regulations but *is* a covered transaction under traditional CFIUS jurisdiction, as it results in "control" by a "foreign person" of a "U.S. business." However, if after the first transaction, Corporation X then leases a tract of land from another person that is in close proximity to a military installation identified in part 1 or part 2 of Appendix A, then Corporation X's lease is a covered real estate transaction (*only* with respect to the lease itself).

3. How do the Regulations address transactions involving real estate in urban areas?

The Regulations provide that if real estate is located in an "urban cluster" or an "urbanized area," such real estate is excluded from the definition of "covered real estate," with certain exceptions as described below. Specifically, "urban clusters" and "urbanized areas" are more densely

populated areas identified as such by the Census Bureau in the most recent U.S. Census. "Urban clusters" have at least 2,500 but fewer than 50,000 individuals, and "urbanized areas" have at least 50,000 individuals. The Regulations note that the Census Bureau maintains an interactive map on its website that allows users to filter by various criteria, including urban clusters and urbanized areas. Real estate in urban clusters and urbanized areas is excluded from CFIUS's real estate jurisdiction unless the real estate is located within, or will function as part of, an "airport" or "maritime port," as defined in the Regulations, or is located within the one-mile "close proximity" radius of certain military installations or other sensitive facilities or properties of the U.S. government identified in parts 1 or 2 of the appendix to the Regulations.

4. How do the Regulations address a transaction involving a real estate within an office building?

The Regulations further provide an exception to CFIUS jurisdiction if a real estate transaction involves certain commercial office space. Specifically, if the commercial office space that is subject to a sale, lease, or concession is within a multi-unit office building, a transaction is excluded from jurisdiction if: (a) the foreign person and its affiliates' holdings in the building do not exceed ten percent of the total square footage of the building in the aggregate, and (b) the foreign person and its affiliates do not represent more than ten percent of the number of tenants in the building. In this manner, the sale, lease, or concession of an entire office building would not fall under the commercial office space exception. We note as well that this exception applies only in the context of the real estate rulemaking and does not apply to transactions involving control of a U.S. business that includes commercial office space, which CFIUS would evaluate under those separate authorities.

5. Are there any other key takeaways from this rulemaking?

While it has long been the case that CFIUS has evaluated national security concerns based on proximity to perceived sensitive locations in the context of the acquisition of control of a U.S. business, there previously has not been this level of clarity regarding which U.S. military and other government facilities would be more likely to trigger CFIUS concern and scrutiny. A key development with the issuance of the Regulations is that, for the first time, CFIUS has published a list of specific U.S. military and other government facilities, organized them to a degree in terms of sensitivity, and tied specific proximity ranges to those facilities for jurisdictional purposes. In this manner, the real estate Regulations provide brighter lines for assessing jurisdictional and voluntary filing considerations than have previously existed for covered control transactions. And while, to be sure, the list does not apply to real estate included in traditional control transactions reviewed by CFIUS under part 800, as discussed below, it may be instructive in that context to parties in assessing national security considerations based on proximity.

6. What steps should parties take in response to the Regulations?

Although the Regulations will not go into effect until early next year, CFIUS now has effectively identified for the public certain locations that it deems sensitive from a national security perspective. Accordingly, while the Regulations do not apply to CFIUS's review of the acquisition of control of a U.S. business, CFIUS may very well now have heightened expectations that parties will file voluntarily with CFIUS when such control transactions involve the acquisition of real estate in proximity to those same locations. Likewise, the risk of not filing such transactions voluntarily now may be increased. Accordingly, parties involved in real estate transactions that involve a U.S. business should work with counsel to identify whether the real estate is in proximity to the newly identified sensitive locations, and whether, on that basis, CFIUS would have an interest in the

transaction. Separately, companies with large real estate portfolios that frequently acquire or sell greenfield real estate — such as, for example, oil and gas companies — may wish to conduct an assessment to determine which of their areas of operations are in proximity to the identified locations such that CFIUS may have jurisdiction over future transactions.

We will continue to keep our clients and friends apprised of developments related to the implementation of FIRRMA.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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