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4 Pitfalls For Foreign Investment In US Real Estate

By **Andrew McIntyre**

Law360, Los Angeles (March 11, 2015, 4:32 PM ET) -- The combination of an incredible amount of foreign capital pouring into U.S. real estate and a market that's seeing properties trade at dizzying paces has created the potential for some foreign buyers to overlook or not pay enough attention to critical aspects of such deals.

While deals involving foreign buyers are always more complex than domestic deals, lawyers say the fast pace of the U.S. real estate market adds yet another layer of complexity and increases the chances for buyers to sidestep certain key considerations.

Here, Law360 looks at four potential missteps in such deals that lawyers should help their clients avoid.

Doing Cursory Due Diligence

As deals in the U.S. are moving more and more quickly, buyers have found the need to do incredibly fast due diligence.

While it's one thing for an experienced U.S. company to ramp up its due diligence efforts to meet a buyer's timeline, it's another matter for a foreign firm, which may not have ever done a deal in the U.S.

"For the outbound investor coming inbound into the U.S., there is some time needed to ramp up to an understanding of U.S. diligence," Leonard X. Rosenberg of Mayer Brown LLP says. "We're seeing deals that change hands very quickly. ... You need to have your ducks in a row when you go into a deal."

Indeed, part of the worry, lawyers say, is that foreign buyers may place a heightened emphasis on trading based on price and may not always entirely see the value in undertaking the due diligence process.

"In dealing with foreign clients, it can be very difficult to get them to focus on the importance of due diligence," Jim Butler of Jeffer Mangels Butler & Mitchell LLP says. "Some foreign clients seem to appreciate due diligence. It's difficult to get [other foreign clients] to focus on some of those elements."

Planning Poorly for Taxes

Lawyers say it's important for buyers to understand their options in terms of how the investment will be set up, how it will be taxed and where it will be taxed.

“There are obviously lots of ways in which to think about and structure an inbound investment to be cognizant of [the Foreign Investment in Real Property Tax Act] and other U.S. taxation issues,” Rosenberg says. “Structure is going ... to affect the ability to repatriate funds going out.”

On the one hand, estate planning is a key consideration, Hemal K. Master of Frandzel Robins Bloom & Csato LC says. Certain structures would subject the property to the U.S. Probate Court, while with other structures the property might not go through Probate Court, he explains.

“Congress and the IRS are always looking at ways to collect additional tax revenue from overseas investment,” Master says. “The paramount [consideration] is going to be the tax implications.”

And investments also need to be set up so the buyer avoids excess taxation in multiple countries, lawyers say.

“If not set up appropriately, you are subject sometimes to taxes in both jurisdictions,” said Jerold B. Neuman of Liner LLP. “Those issues have to be considered.”

Forgetting Financing

Oftentimes buyers are so one-dimensionally focused on the acquisition portion of the deal that they don’t place proper focus on financing the deal.

While buyers may revel in the fact that they’ve won the footrace to purchase a trophy property, if the financing isn’t there, that win is hardly a win, lawyers say.

“People worry about execution risk,” Rosenberg says. “Buyers need to not only have capital ... [but also have] the ability to close the deal. A deal you don’t close is worthless.”

The financing needs to be in place early, but attention also needs to be paid to exactly how the property will be financed.

“How is the financing being structured?” Neuman asks. “Is there going to be financing?”

Breaking From the Basics

What’s often lost in the race to do a U.S. real estate deal is the importance of carefully thinking through all the aspects, as opposed to acting quickly to get a deal done.

“I think a key, really, is to stick with the basics,” Butler says. “Are the prices that are being paid reasonable? Are the deal structures going to be viable?”

“We’re reaching a point where one does have to look at the prices that are being paid and the values. It is a concern as to whether they are sticking with the basics," Butler adds.

Indeed, with comparisons between Japanese investment in U.S. trophy properties in the late 1980s and the current wave of Chinese investment, foreign investors need to exercise caution when doing such deals, and they should — alongside their counsel — consider the deal from all angles.

“It does create the question of whether this is ’hot’ money, money which may find an investment home without regard to value or price,” Butler says. “When that happens, it’s very easy for people to forget the fundamentals and basics.”

--Editing by Jeremy Barker and Edrienne Su.
