



# STROOCK

## SPECIAL BULLETIN

## CFIUS and The Waldorf Astoria:

### What Real Estate Professionals Need to Know About National Security Reviews

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In the many news reports about the U.S. commercial real estate market published during 2015, one U.S. government committee stood out with unusual frequency: the Committee on Foreign Investment in the United States (“CFIUS” or “the Committee”). CFIUS is an inter-agency group that assesses the national security impact (if any) of foreign acquisitions of U.S. businesses. “Businesses” can include, in many cases, the ownership or operation of U.S. real estate.

Although CFIUS approves the majority of the acquisitions it reviews, deals that do not pass CFIUS muster may be vetoed by the President. CFIUS can even recommend that the President unwind a transaction after the fact. Accordingly, with ever-widening concern over the national security implications of foreign investment, it is an absolute must both to know the requirements of the laws governing CFIUS and to consult with professionals to help analyze the risks of a given deal. It has become increasingly clear that submitting a transaction for CFIUS review may be the most prudent action in certain real estate deals.

One headline-grabbing real estate deal in 2015 was the acquisition of the Waldorf Astoria Hotel by the Anbang Insurance Group of China.<sup>1</sup> Not only the official residence of the U.S. Ambassador to the United Nations, the Waldorf is also a frequent venue for high profile political gatherings and hosts many senior U.S. and foreign government officials. For reasons not publicly disclosed, the Waldorf transaction was submitted to the Committee for review.

Although the Waldorf transaction was ultimately approved by CFIUS, many observers were surprised that it was submitted for review at all. They shouldn’t have been. Over the past several years, Congress and CFIUS have expanded the concept of “national security” to reflect changing times. Chinese acquisitions, in particular, have received close scrutiny. Also, review and approval by CFIUS can provide a buffer against possible public criticism and may provide comfort to

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<sup>1</sup> “Chinese Insurer Gets Go-Ahead to Buy Landmark US Waldorf Astoria Hotel,” *South China Morning Post* (Feb. 3, 2015) (available at <http://www.scmp.com/business/companies/article/1699934/chinese-insurer-gets-go-ahead-buy-landmark-us-waldorf-astoria>).

lenders concerned about the risk that, absent review, a deal may end up being unwound after closing. Although the Waldorf is situated well outside the traditional defense sector, its role as the residence and temporary home of high-ranking government officials (foreign and domestic) made the acquisition a logical candidate for review at a time when cybersecurity is a key national security concern.

Increased foreign interest in U.S. real estate makes the Waldorf CFIUS review a likely bellwether. While the purchase of the Waldorf was a first on many levels – the largest U.S. real estate acquisition by a Chinese company, the first acquisition of a landmark U.S. hotel by a major Chinese investor, and the first large acquisition by a Chinese insurance company outside China – it was only one transaction in what shaped up to be an extraordinary 2015 for foreign acquisitions of U.S. commercial real estate. Foreign purchases totaled nearly \$85 billion in the first ten months of 2015 – more than doubling \$41 billion in foreign direct investment in U.S. commercial real estate in 2014.<sup>2</sup> In particular, Chinese investment in U.S. real estate is on the rise. In 2014, Chinese investment in U.S. commercial real estate amounted to \$3.9 billion; and as of November 2015, Chinese acquisitions of U.S. commercial real

estate had already exceeded \$10.2 billion.<sup>3</sup> News reports consistently indicate that foreign investment in the U.S. real estate market will continue to grow.<sup>4</sup>

Parties contemplating a real estate transaction may think that the likelihood of their deal implicating national security is farfetched. In many cases, they will be right; however, the Committee’s recent history portends an increased interest by CFIUS in real estate deals. Close analysis may prove that a deal presents no realistic threat to national security, but it is still important to do the analysis.

Even in otherwise innocuous transactions, national security issues may arise if a targeted asset is near a sensitive government facility (like many buildings in DC, for example), or critical infrastructure (such as a bridge, tunnel or airport). Such “persistent co-location” was undoubtedly the key factor in the President’s decision in 2012 to shut down the Chinese-controlled acquisition of

<sup>2</sup> “As the World Snaps Up U.S. Real Estate, Are Bubble Fears Overblown?” *Institutional Investor LLC* (Nov. 24, 2015) (available at <http://www.institutionalinvestor.com/article/350855/5/asset-management-hedge-funds-and-alternatives/as-the-world-snaps-up-us-real-estate-are-bubble-fears-overblown.html#.VnHpeLdg19A>); “Foreign Investment in U.S. Poised for Record?” *Daily Real Estate News* (Aug. 20, 2015) (available at <http://realtormag.realtor.org/daily-news/2015/08/21/foreign-investment-in-us-poised-for-record>).

<sup>3</sup> “Chinese Real-Estate Firm Looks West—to California,” *The Wall Street Journal* (Jan. 27, 2015) (available at <http://www.wsj.com/articles/chinese-real-estate-firm-looks-westto-california-1422385081>); “NYC Real Estate Still Attractive to Chinese,” *China Daily* (Nov. 13, 2015) ([http://usa.chinadaily.com.cn/world/2015-11/13/content\\_22454072.htm](http://usa.chinadaily.com.cn/world/2015-11/13/content_22454072.htm)).

<sup>4</sup> See, e.g., “Qatar Wealth Fund to Open New York Office as U.S. Portfolio Grows,” Reuters (Apr. 30, 2015) (available at <http://www.reuters.com/article/2015/04/30/qatar-swf-usa-idUSL5N0XR3U120150430>) (quoting Qatar News Agency announcement); “Qatar’s Sovereign Wealth Fund Opens Office in New York,” *The Wall Street Journal* (Sept. 28, 2015) (available at <http://www.wsj.com/articles/qatars-sovereign-wealth-fund-opens-office-in-new-york-1443453076>); “China Vanke Buying Majority Stake in Bush Tower for \$125M,” *The Real Deal* (<http://therealdeal.com/blog/2015/04/27/china-vanke-buying-majority-stake-in-bush-tower-for-125-million/>) (Apr. 27, 2015).

windfarms near a sensitive military installation.<sup>5</sup> Other less prominent deals may also have been restructured to address national security concerns and avoid a Presidential veto or unwinding. In light of the heightened scrutiny of real estate deals, therefore, it is important to understand how CFIUS works.

## Overview of CFIUS

Chaired by the U.S. Department of the Treasury, CFIUS is composed of representatives from nine Executive Branch agencies, including the Departments of Defense, Commerce, Homeland Security, and State. The Director of National Intelligence is a non-voting member. Certain other offices – including White House offices such as the Council of Economic Advisors and the Assistants to the President for National Security Affairs, Economic Policy, and Homeland Security and Counterterrorism – have observer status.

Although filing is ostensibly voluntary, CFIUS has the right to review any merger or acquisition that could result in foreign control of a U.S. business. There are no civil penalties for not filing, but, in recent years, CFIUS has become more aggressive in exercising its authority to review, of its own volition, transactions that have not been voluntarily filed. In all cases, CFIUS review involves an initial 30-day assessment and the potential for an additional 45-day investigation. Approval provides a “safe harbor.” Importantly, transactions that are approved may only be reopened by the Committee under extremely

limited circumstances, essentially fraud or misrepresentation.

If a covered transaction is not reviewed, however, it is subject to review and potential unwinding – in perpetuity.<sup>6</sup> As a matter of practice, the buyer generally takes the risk of any subsequent unwinding or mitigation that may be imposed, unless otherwise allocated in the deal documents. For this reason (and because it may be in the seller’s interest to clarify the circumstances under which the buyer may or may not abandon the deal if it does not like the terms of a proposed CFIUS mitigation), parties to a deal will generally want to discuss the prospect of CFIUS review up front and assess whether and how to allocate related risks in their deal documents. Rather than face the risks of CFIUS review post-closing, buyers and sellers are well advised to file whenever a transaction implicates U.S. national security.

## CFIUS Jurisdiction – Real Estate

Certain jurisdictional hurdles must be cleared before CFIUS may review a transaction. CFIUS has jurisdiction over any “covered transaction,” which is any acquisition, merger or takeover that could result in control of a “U.S. business” by a foreign person.<sup>7</sup> A “U.S. business” includes assets that are operated as a business undertaking, even where not separately incorporated, and thus may include the acquisition of real estate.

Control does not require majority control. It exists whenever a foreign person has the ability (whether or not exercised) to “determine, direct, or decide” *important business matters affecting an entity*,<sup>8</sup> such as the ability of a minority investor to

<sup>5</sup> See Anne Salladin and Amelia Schmidt, “CFIUS Post-Ralls: Ramification for Sovereign Wealth Funds,” *Qatar International Review of Law* (May 2015) (available at <http://www.qscience.com/doi/abs/10.5339/irl.2015.swf.4>).

<sup>6</sup> See *infra*, note 13.

<sup>7</sup> 31 C.F.R. § 800.207.

<sup>8</sup> *Id.* § 800.204.

block important business matters affecting the U.S. business. This is different from a traditional control test.

Depending on its structure, a real estate transaction could well be a “covered transaction.” For example, a purchase by a foreign person of a U.S.-incorporated entity, or of a controlling interest in a joint venture (including a joint venture that owns or manages real estate), could constitute a covered transaction. The acquisition of one or more real estate assets could also constitute a covered transaction, if the assets (in whole or in part) were necessary to operate a particular business. As a result, the purchase of hotels and other occupied buildings (such as buildings with existing tenant leases), contracts, intellectual property, good will, and a staff of management and maintenance personnel, could be a “covered transaction.”

### National Security Considerations

If there is reason to believe that CFIUS would have jurisdiction over a particular transaction, it is prudent to consider whether the transaction could present national security considerations. Besides “proximity,” key issues involve whether the assets themselves are deemed “critical infrastructure”<sup>9</sup>

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<sup>9</sup> See 50 U.S.C.A. § 2170(f)(6). The Foreign Investment and National Security Act defines “critical infrastructure” as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.” *Id.* § 2170(a)(6). CFIUS determines what constitutes “critical infrastructure” on a case-by-case basis, depending on the nature of the asset(s) involved in the transaction and its importance to the United States. See Office of Investment Security, Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74,567 (Dec. 8,

(for example, power stations or ports), house the manufacture or storage of “critical technologies,”<sup>10</sup> or include sensitive government agency tenants.

For example, the purchase of an energy company, including railroad, pipeline, and other real estate assets, by a foreign person could raise national security considerations. Not only does supply of energy in and of itself potentially affect “critical infrastructure,” but the location of the real estate assets near such infrastructure could raise national security issues. “Proximity” concerns would undoubtedly trigger review (for example) of a covered transaction involving leases for retail stores in, or close by, a major transportation hub, such as an airport or train station. So could the acquisition of a real estate portfolio (or even a single building) where the federal government is a tenant, especially if the government agency is sensitive and the lease is long-term.

Due diligence should include an inquiry into the security profile of the building (*e.g.*, whether it is deemed within the “security perimeter” of sensitive federal buildings). In some cases, use of U.S. property managers may help mitigate any national security concerns – but still would not eliminate the prospect of a review. Although mitigation may address national security concerns, CFIUS may want guarantees that mitigation will remain in place for as long as the foreign owner owns or controls the property.

The confidential nature of the CFIUS process means that there is little public information about how the Committee treats particular real estate

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2008) (available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf>).

<sup>10</sup> See 50 U.S.C.A. § 2170(a)(7), (f)(7).

transactions. What is clear is that the Committee will consider all the facts of the deal, including whether the structure of the deal involves the purchase of a collection of assets, or ownership interests, or a joint venture, or leases. With the increase in the number of foreign investors in U.S. real estate, it is essential for companies to consult experienced CFIUS counsel to identify and help address potential concerns, which can include anticipating a CFIUS review in the deal documents. Early consultation can avoid costly mistakes.

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