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Outlook on Foreign Investment in U.S. Commercial Real Estate

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Foreign investment in U.S. commercial real estate has dramatically increased over the past several years. Foreign investors have long viewed the United States — in particular, trophy assets and other properties in cosmopolitan markets in California, New York and Miami — as a safe place to park their money while seeking steady returns. However, in the first half of this year, we have seen a sharp decline in the amount of foreign investment in U.S. commercial real estate, in particular, by Chinese investors. For the first time in seven years, foreign investors in U.S. commercial properties, including office buildings and retail space, sold more than they bought, with purchases of these properties totaling $21.3 billion and sales totaling $21.4 billion.

While the drop may be due in part to some large acquisitions that closed last year, there are several additional factors that may account for such a plunge. Fears of an impending recession and uncertainty over U.S. interest rates have made buyers more cautious, and the stronger U.S. dollar has made purchasing U.S. properties more expensive. In addition, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) significantly expanded the authority of the Committee on Foreign Investment in the United States (CFIUS) to review foreign direct investment in certain properties and may have chilling effects on the purchase of real estate by foreign investors. Any purchase, lease, concession or other change in the rights of a foreign person in real estate that is proximate to a U.S. government national security-sensitive installation is subject to the review and scrutiny of CFIUS. If risks are identified by CFIUS, there may be ways to mitigate the risks through modifications to the transaction or post-transaction controls. However, if CFIUS determines that such risks cannot be mitigated, CFIUS may recommend that the U.S. President block or, if the transaction is closed, unwind the transaction. Such expanded and heightened scrutiny may curtail foreign investment in U.S. projects and properties as such investments become more difficult and more expensive.

Changes to the EB-5 investments program, which take effect on November 21, 2019, also are likely to impact foreign investment. The EB-5 program offers a way for foreign citizens to obtain green cards by investing in qualifying real estate projects. The new rules taking effect at the end of the year will increase the minimum investment required under the program for targeted employment areas from $500,000 to $900,000, and the U.S. Citizenship and Immigration Services (USCIS) now will directly review and determine the designations of high-unemployment targeted employment areas (“TEAs”) rather than deferring to TEA designations made by state and local governments. These changes, along with increasing the investment requirement for projects outside of the TEAs from $1 million to $1.8 million, are likely to reduce the number of foreign investors making investments in real estate through the program.

In prior years, approximately 85% of the EB-5 green cards were issued to Chinese nationals, but that percentage has dropped recently since the wait times for Chinese investors for EB-5 green cards can be more than 10 to 15 years. But additional factors also have resulted in investment from Chinese investors, one of the biggest purchasers of U.S. commercial real estate in recent years, to drop dramatically in the past year. Recent trade disputes between the United States and China over tariffs could have more far-reaching effects. In the past, some of the biggest commercial real estate deals, including the purchase of 245 Park Avenue by HNA Group for $2.21 billion in 2017 and Anbang Insurance Group's acquisition of the Waldorf Astoria in New York City in 2014 for $1.95 billion, had Chinese buyers. There has been a retreat by Chinese investors in commercial real estate recently, in part due to China’s capital controls on outbound investments. In addition, when the Chinese yuan fell to an 11-year low, the Chinese government placed additional capital restrictions on taking money out of China and investing in real estate overseas.

Despite the decline by Chinese and other foreign investors in the first half of this year, foreign investors will likely continue to invest in U.S. commercial real estate, although the form of such investment may change. Certain foreign money managers have been putting their money into stocks and bonds of REITS and real estate companies. Other investors have chosen to structure their investments in the form of debt rather than equity, which they view as a safer bet in the event of a recession. South Korean institutional investors have been particularly active in the purchase of real estate debt, accounting for approximately 21% of all foreign investment in U.S. real estate debt. The recent drop in interest rates, resulting in lower hedging costs, may be enough to spur continued foreign investment, and U.S. real estate still offers the potential for higher returns compared to the rates of return in London and parts of Asia. While recent financial market volatility may make investors more cautious, the U.S. economy continues to be growing faster than most other global economies, and the U.S. commercial real estate market is still the largest and most liquid real estate market in the world.