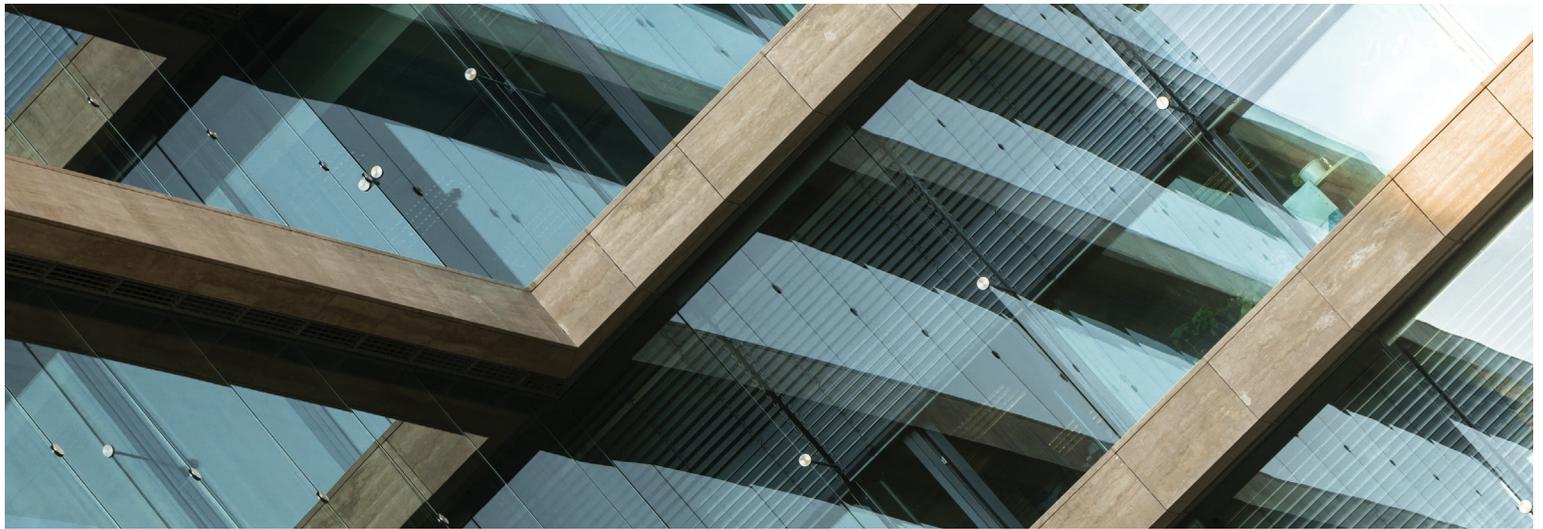


PAUL
HASTINGS

INVESTING IN THE U.S. REAL ESTATE MARKET: OPPORTUNITIES FOR GROWTH





INTRODUCTION

The U.S. real estate market has drawn exceptional levels of inbound investment interest during 2013-14 and has continued its appeal to investors, institutions, and sovereigns. Non-U.S. investors acquired nearly \$23 billion in U.S. real estate in 2013 alone, up 12% from the previous year. From New York City to Los Angeles, from San Francisco to Miami, the skyline is dotted with cranes for projects that are owned by non-U.S. entities. While the U.S. is a relatively open market for international investors, it is important to recognize that there are important issues to consider as part of your real estate investment strategy.

The lawyers in our leading Global Real Estate practice have deep experience advising Asian clients on their outbound investments, whether they are entering the U.S. market for the first time or taking on new acquisitions in a major expansion of their business. We understand both the unique contours and challenges of the U.S. market and the specific business objectives of our Asian investor clients. Our collaborative interdisciplinary approach enables us to develop sophisticated structures and innovative solutions for some of the most complex multi-jurisdictional real estate deals in the world.

Leader in Asia

With offices in Hong Kong, Shanghai, Beijing, Tokyo, and Seoul, we provide coverage of the key north Asian markets. We have worked in the region since the 1970s when we began helping our clients establish themselves in the U.S. market. We understand the challenges companies face in dealing with the U.S. market and have a strong record of success in helping them navigate this complex business environment. In addition, our lawyers are local experts, with firsthand knowledge of their markets and experience structuring successful cross-border real estate investments. Our team includes professionals fully fluent in the key languages of north Asia, ensuring easy communication across borders and in delivering support worldwide to our Asian clients.

First-Rate Experience of the U.S. Real Estate Market

As importantly, our team has consistently delivered groundbreaking real estate deals for our clients in the Americas, Asia, and Europe. Our leadership in real estate both globally and nationally in the U.S. has been acknowledged by the market and by our peers, year after year. You have the assurance of dealing with professionals with the most up-to-date knowledge of market conditions and opportunities, and with a strong track record of helping clients achieve success in this highly competitive marketplace. With prime assets constantly in the sight lines of major buyers, you need advisers who can move quickly to deliver the right support when you need it. Paul Hastings can help.

INDUSTRY RECOGNITION

- Real Estate Practice Group of the Year – *Law360, 2013*
- Ranked as a First Tier Firm for U.S. Real Estate – *The Legal 500 USA, 2011-2014*
- Band 1 in Nationwide Real Estate – *Chambers, 2011-2014*
- North America Law Firm of the Year (Transactions) – *2013 Global PERE Awards*
- Asia Law Firm of the Year (Fund Formation) – *2013 Global PERE Awards*
- Real Estate Law Firm of the Year – *Asian Legal Business, 2014*
- International Real Estate and Construction Team of the Year – *China Law & Practice, 2011-2013*

Full-Service Legal Counsel for Your Real Estate Needs

We provide a full range of services to the real estate industry, from fund formation through restructuring. Our professionals have advised on the full gamut of emerging areas – from the increasingly important arenas of environmental law and compliance to the fast-growing data center sector. We have established strengths in every aspect of real estate debt and equity capital markets, IPOs and REITs, finance and securitization through to asset acquisitions, disposals, land use and construction. You have the assurance of knowing that we can call on these areas of expertise as needed to advise on every aspect of your deal.

We believe that our service offering provides a clear point of differentiation in terms of the caliber of our professionals, our in-depth knowledge of the U.S. market and our capacity to work with you in Asia, the United States, and globally. We welcome the opportunity to work with you.

The Practicalities of Investing in the U.S. Market

In the following pages we have outlined the most common approaches and some of the key terms involved in real estate investments in the U.S. We hope this information will provide the basis for a more in-depth discussion of your investment strategy and legal needs.

INTERESTS IN U.S. PROPERTY

There are three types of interest that an investor can hold in U.S. property:



PURCHASE AND SALE

Investors who want “fee ownership” of a property will enter into a Purchase and Sale Agreement that spells out the terms and conditions for them to purchase the property. The investor might purchase the actual property itself, or the membership interests in an entity that owns the property. Generally, the purchaser places a good faith deposit (typically 2-3% of the actual purchase price of the property) in escrow while they perform due diligence on the property.

This agreement usually gives a “free out,” or “free look” period, where the deposit is not at risk until due diligence is complete and waived. Purchase and sale transactions are typically “as-is,” although purchasers may want to negotiate concession and warranties from the seller regarding the property.

PURCHASE AND SALE DUE DILIGENCE

Title: The purchaser’s lawyer will review the property’s title commitment. This is an insurance policy issued by a third party title insurer to the purchaser when the premium is paid and certain other conditions set forth in the commitment are satisfied. The policy covers the purchaser against certain enumerated risks around property title. Title due diligence consists of verifying the seller owns the property and identifying and evaluating any other rights over, interests in, or claims on the property.

Survey: A survey serves two basic purposes in the real estate transaction. First, it illustrates the physical relationship between the property, the buildings, and improvements on the property and the easements and other matters contained in recorded documents. This allows counsel to evaluate whether any easements or restrictions interfere with the contemplated use of the property. Second, it may disclose rights or interests in the property not reflected by the public records. For instance, the survey may show utility lines crossing the property to serve a neighboring property, which require access across a neighboring parcel.

Compliance with Laws: Legal compliance due diligence provides assurance that the property is in compliance with laws governing its use and occupancy, such as zoning laws and building codes. If the property is not in compliance, its continued use may be under threat. This could not only disrupt future income streams, but also require significant sums spent to bring it into compliance.

Lease Review: Generally a purchaser will review the leases on the property to confirm: the amount of rental income due and that the leases contain commercially reasonable terms and conditions (i.e., the use of the premises is appropriately limited, the maintenance and restoration obligations are appropriately allocated between landlord and tenant, landlord consent is required for certain actions such as assignment or subleasing, and appropriate remedies [including termination] exist for a default by the tenant).

Environmental: Hazardous substances pose several risks for purchasers. In addition, in the U.S. there is increasing public awareness of environmental issues and concerns. This makes it particularly important that environmental risks are carefully addressed. There are three critical considerations:

- First, the purchaser acquiring property is liable for the removal of any hazardous substances on the property.
- Second, some environmental statutes authorize a governmental authority to dispose of hazardous substances and impose a “superlien” on the property, with priority over prior recorded mortgages for the amount of the cleanup costs.
- Third, the presence of hazardous substances will impose a cleanup cost on the owner and, depending on the cost of the cleanup, increase the risk of a default.

The minimum due diligence requirement for any property acquisition is a “Phase 1” environmental report prepared by a qualified environmental engineer. The phase 1 report should consist of the following:

1. 50-year title search to determine whether the property has been owned by a person or entity likely to have used hazardous substances, such as a chemical manufacturer or oil company
2. Search of public records identifying sites containing hazardous substances (i.e., list of cleanup sites maintained by the U.S. Environmental Protection Agency)
3. Physical inspection of the site for surface evidence of hazardous substances, such as fuel tanks and drums or friable asbestos

Ideally the Phase 1 report should confirm that there are no environmental risks associated with the property.

DEVELOPMENT DEALS

Overseas investors looking to develop a piece of property (as opposed to purchasing an existing asset) will face a host of additional legal issues. There are a number of governmental approvals required in connection with these deals, which vary not only state by state, but also city by city. In addition, a purchaser will have to hire architects and engineers, as well as obtain construction financing. Development deals also require an understanding of the mechanics lien laws of the state where the property is located.

JOINT VENTURES

Many times, a purchaser will enter into a joint venture agreement (typically a limited liability company agreement) with another party to acquire the property. In some instances, the joint venture is a 50-50 deal where both parties contribute equal amounts of money and have equal approval rights for decisions affecting the property.

In other instances, the joint venture will be in the form of an arrangement between a “developer,” with the expertise in developing or refurbishing a property, and a capital partner who provides the bulk of the finance. There are a number of items that get negotiated between the parties in a joint venture agreement, including the initial capital contribution, the distribution of cash flow to the joint venture, what happens if the joint venture needs additional capital (and the consequences when one party fails to contribute such capital), approval rights for major decisions, dispute resolution between the parties, and exit strategies.

OTHER REAL ESTATE AGREEMENTS

There are other types of agreements that non-U.S. investors may deal with, which include:

Property Management Agreements

An agreement where the owner hires a manager to handle the day to day operations at the property

Listing Agreements/Brokerage Agreements

An agreement where the owner engages the services of a broker to either lease or sell a property

Development Services Agreements

In the event the purchaser is looking to develop property, an agreement with a developer who agrees to provide development services expertise

Leases

An agreement between a property owner and a tenant in which the tenant is granted the exclusive right to occupy certain premises for a defined period of time in exchange for payments of rent



TAXES

Tax has a significant impact on U.S. real estate transactions. The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) taxes non-U.S. investors on gains from U.S. real property investments at effective federal income tax rates up to 54.5%. Additional state income taxes may also be payable. FIRPTA also requires that an investor file U.S. tax returns and submit to the investigatory and subpoena powers of the IRS. There is no “silver bullet” that resolves all of the issues FIRPTA presents to non-U.S. investors.

There are a number of tax issues that a non-U.S. investor should be aware of with respect to real property:

Ownership/Operation of the Property

- Income taxes/withholding taxes
- State and local income taxes
- Tax return filing obligations
- Property taxes
- Sales and use (or gross receipts) taxes

Disposition of the Property

In addition, non-U.S. investors have special issues associated with:

- Federal income taxes
- State and local income taxes and sales taxes

FIRPTA Withholding

This requires that 10% of the gross sales proceeds of a real property disposition be withheld for foreign sellers unless certain exemptions apply

Effectively Connected Income (ECI)

Income and gain from non-U.S. investors are generally taxable under the ECI rules. Specifically, rental income and/or gains from the sale of U.S. real estate are treated as ECI

Non-U.S. Regulatory Concerns

In addition to tax issues, non-U.S. investors may have certain informational reporting requirements in their home jurisdiction

Various U.S. Real Estate Investment Structures

- High yield debt investment
- Leveraged blocker
- Unleveraged blocker
- Domestically controlled private REIT
- Direct investment

Therefore, it is of crucial importance for non-U.S. investors to work with tax counsel in the U.S. as well in their home jurisdiction to properly structure their U.S. investments prior to entering into any binding investment agreements.

REPRESENTATIVE CLIENTS



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