$1.50 VOL. 39 NO. 19 www.ocbj.com MAY 9-15, 2016

ORANGE COUNTY BUSINESS JOURNAL

Stuart Kane LLP

PATH and OFAC Unwind Restrictions on Foreign Investment

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As real estate attorneys serving multiple sectors of the real estate industry, clients often ask us about trends we see in the real estate market. While some of our responses are anecdotal, from patterns in the transactions we handle, we also monitor developments in federal, state and local law, giving us added insight into developing trends in the market.

Recent changes in two Federal laws point to potentially positive trends for real estate investment. The Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") has modified the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), which should result in increased investment in U.S. real estate by foreign investors. For U.S. investors looking for new investment opportunities outside the U.S., the restoration of diplomatic relations between the U.S. and Cuba, and the subsequent modifications to the Cuban Assets Control Regulations (the "Cuban Regulations") implemented by the Department of the Treasury's Office of Foreign Assets Control ("OFAC"), appear to be the first steps toward eventual investment opportunities in Cuban real estate.

Following the PATH around FIRPTA

When FIRPTA became law in 1980, one of the notable requirements imposed on non-U.S. investors was a tax withholding requirement when disposing of U.S. real property interests. Specifically, FIRPTA treated nonresident alien individuals, foreign corporations, foreign partnerships, foreign trusts, and foreign estates all as "foreign persons" for the purpose of being subjected to tax withholding upon the sale of real property, or of interests in entities that held real property.

The PATH Act, which became law in December 2015, and for which the IRS issued final regulations in February 2016, creates a new carve-out to the "foreign person" category under FIRPTA, excluding qualified foreign pension funds, and any entity that is wholly owned by such a qualified foreign pension fund. So, for the first time in more than 35 years, a significant deterrent to investment in U.S. real property by foreign pension funds has been removed.

From our perspective, there was already an increase in foreign investment in U.S. real estate during this cycle, from qualified foreign pension funds and other foreign entities. Now, with the PATH Act clearing the way for qualified foreign pension funds to avoid tax withholding when disposing of U.S. real property investments, we expect to see more qualified foreign pension funds bidding on acquisitions, and getting involved in equity investment and joint ventures in the U.S. real estate market.

The New Revolution in Cuba

As opposed to the "inconvenience" FIRPTA created with tax withholding on foreign investment, President Kennedy's 1962 Proclamation 3447, the Embargo on All Trade with Cuba, began the long-standing prohibition on U.S. investment in Cuba, further reinforced by the Cuban Assets Control Regulations, codified in 1963. That, coupled with Cuba's own laws prohibiting foreign-owned real estate in Cuba since 1962, has made U.S. real estate investment in Cuba a non-starter.

Even with the recent diplomatic developments between the countries, there is a very long way to go before a U.S. national will be able to "own" real property in Cuba. But the recent OFAC modifications to the Cuban Regulations have begun to open those long-closed doors to economic opportunity in Cuba.

When the Obama administration announced that OFAC would amend the Cuban Regulations to implement policies designed to engage and empower the Cuban people, specific directives cited were to facilitate travel, expand financial transactions, and authorize additional business and physical presence in Cuba.

Following the 2015 restoration of diplomatic relations between the countries, OFAC issued an order on March 16, 2016, to further expand the Cuban Regulations to allow U.S. persons to establish business presence in Cuba, for the exporting of goods, providing of mail, parcel and cargo services, and travel and carrier services.

That same month, President Obama became the first sitting president to visit Cuba since Calvin Coolidge. During that visit, an announcement was made to illustrate what these OFAC changes would bring: Starwood and Marriott were being authorized by OFAC to operate hotels in Cuba. While their pending merger awaits regulatory approval in Europe and China, Starwood and Marriott are not purchasing real property (which is still prohibited under Cuban law and U.S. law), nor are they building new hotels in Cuba. Instead, they will simply be managing and operating existing properties for the existing Cuban ownership. In a press release issued on March 19, 2016, Starwood indicated it was engaged in transactions to rebrand and manage three hotels in Havana. Marriott's press release the next day referenced the opportunity to provide Cubans with hospitality training, generate new economic opportunities, and support opportunities for youth, women and other communities in Cuba, as a corporate citizen.

This historic development followed on the tails of an agreement between the U.S. and Cuba to allow U.S. airlines to resume and expand commercial service to Cuba. Under President Raul Castro since 2006, the Cuban government has also started to allow residential real estate ownership by Cubans, something that was also, until recently, not permitted.

And with that, after almost 55 years of prohibited trade with Cuba, we see the first steps toward a "new" revolution in Cuba for economic development, and potentially investment opportunities for the U.S. and the rest of the world.

Looking Ahead

With the implementation of the PATH Act, we look forward to monitoring deal flow in 2016, to see if there is indeed an increase in the number of qualified foreign pension funds that invest in the U.S. real estate market. Ideally, the new law should precipitate increases in the volume of transactions, and the dollar amounts involved. For our clients, we hope it translates to a greater number of transaction partners, and new sources of capital.

Similarly, with the easing of restrictions by OFAC on U.S. economic activity in Cuba, the events to come in 2016 should be the start of a historic period in both diplomatic and economic relations between the U.S. and Cuba. It will be interesting to see how real estate and other investment opportunities in Cuba evolve in the years to come, following this new revolution in U.S. relations with Cuba.

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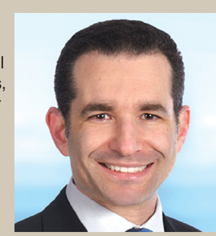

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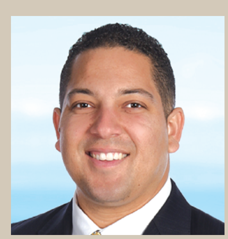

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