“Trends in Foreign Investment in Cross-Border Real Estate”

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I. Introduction: Global Economy,

A. Companies can choose to set up business and investment operations wherever they wish.
B. Due to the global economy, U.S. companies wish to enter new markets before competitors; Real Estate transactions used to be more local and domestic, however, the development of real estate private equity has made it a more global practice.
C. The weaker U.S. Dollar, particularly vis-à-vis Euro, affords U.S. companies new export opportunities, and makes imports more expensive; Caterpillar and other heavy equipment makers have increased sales in China, India, the Middle East, and elsewhere, even as U.S. sales have slowed. The weaker Dollar also benefits stock of overseas U.S. corporate investment by raising its Dollar value. On March 9, 2011, the exchange rate was at $1.40 per €1.00.
D. In 2010, for the seventh year in a row, Texas was ranked as the number one State by export revenues. Texas exports for 2010 totaled $206 billion. Texas' top export markets are Mexico, Canada, China, and the Netherlands, and the top export industries are chemicals, computers, electronics, and machinery.
E. Creation of regional trading blocks, new free trade agreements, and international business developments as follows:

1. <u>Regional Trading Blocks:</u>

a. <u>European Union.</u> The EU is a customs union and a single internal market (not just a free-trade area) based on the free movement of goods, services, persons, and capital: It has a common external tariff vis-à-vis non-member countries, and has the power to create supra-national EU law, which prevails over the national laws of the 27 Member States. The European Union's eastward expansion will most probably include Croatia as its next member.

b. <u>North American Free Trade Agreement (NAFTA)</u>. Population of 387 million consumers (three members) – In 1994, United States, Canada and Mexico create a free trade area; U.S. companies sold $45 billion in goods to Mexico in 1993 before NAFTA. In 2009 that figure was $128 billion a year. Much of those goods came through Texas creating jobs here.

2. <u>Free Trade Agreement:</u>

a. <u>European Union - Mexico Free Trade Agreement.</u> Effective as from July 1, 2000, it reduces tariffs on goods and services over a 10-year period with the following benefits:

1. The Mexico-EU Agreement may be used as a bridge to Latin America, particularly with those countries which Mexico has

executed, or is negotiating Free Trade Agreements (e.g. Colombia, Venezuela, Chile, Costa Rica, Honduras) along with complementary Economic Agreements with Argentina, Brazil and Uruguay. Mexico has 11 Free Trade Agreements in place with 41 different countries.
2. U.S. companies with a real presence conducting business in Mexico are in a better position to export to Europe from a lower customs duty perspective.

b. U.S. – Korea Free Trade Agreement. This was announced on February 2, 2006, signed in 2007, with a renegotiated version in December 2010, and is pending ratification at this time. It has not yet been ratified by South Korea or the US Congress. South Korea is 11th largest economy in world. This is the second largest free trade agreement for the US, after NAFTA.

Pending Free Trade Agreements. Proposed trade agreements with Columbia, South Korea, and Panama are pending.

c. MERCOSUR - South American trade agreement grouping consisting of Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

3. Association of Southeast Asian Nation (ASEAN). 10 members, consisting of Brunei, Indonesia, Thailand, the Philippines, Malaysia, Singapore, Myanmar, Cambodia, Laos, and Vietnam. ASEAN signed a Free Trade Agreement with China.

4. World Trade Organization (WTO). WTO membership of 153 country members expands market and investment access to its members and provides dispute settlement rules. Vietnam, Cape Verde, Russia and Ukraine are recent members. Likely to see more U.S. trade and investment with these countries.

5. World Economies. Largest economies are U.S., Japan, China, India, Germany, and if the European Union is viewed as one economy, it would be equally as large as (if not larger than) the U.S. economy: The European Union and the United States are the two largest economies in the world. Taken together, they account for about one-half of the entire world economy.[2]

    a. China and India are now major acquisition players (e.g. Unocal-China; Mittal Steel – India).

[2] http://www.eurunion.org/profile/facts.htm

6. EU Development. EU Lisbon Treaty. Treaty signed by foreign ministers of the EU on December 1, 2009. The Lisbon Treaty provides for an EU President and an EU Foreign Minister.
7. US Stimulus Package (2009). The US Economic Stimulus Package will help US workers and companies, but its "Buy America" provisions are viewed by many international trade partners as trade restrictive provisions. "Buy America" provisions covers public procurement that is purchases by governments. The EU feels these purchases are protectionist measures and restrict competition.

II. Currency Movements.

A. Weak U.S. Dollar – In 2002 the Euro was worth around $0.90 on average. On March 9, 2011, each Euro is worth $1.40, making the purchase of U.S. assets less expensive, and hence, more attractive.

B. Interest Rates – The European Central Bank's current policy of higher interest rates of 1% to curtail inflation vis-à-vis much lower interest rates of 0% in the U.S. continues to weaken the U.S. dollar and Bank of England rates of 0.5%. Czech Republic's central bank rate is 1.75% and South Africa's rate is 10.5 %.

C. EU Globalization of Production. By shifting EU production into China and other Asian countries tied to the U.S. Dollar, EU companies can hedge against a strong Euro. For big players like Airbus, whose costs are priced in Euros while their products are priced internationally in U.S. Dollars, the Euro's strength creates problems if not adequately addressed. European companies, because of the social legislation and labor laws, do not have the same flexibility that U.S. companies have to outsource and shift production.

D. U.S. trade imbalance hit $497.8 billion in 2010[3]. U.S. exports are growing faster while foreign imports are more expensive.

E. Chinese Yuan, the value of which is carefully managed against the Dollar by the Chinese Government, is making Chinese exports even more competitive. Henceforth, pressure by the US Government to allow it to float. Chinese trade is done in U.S. Dollars, so when the U.S. Dollar weakens, Chinese products are more competitive. The Chinese Government recently announced the formation of a new agency to oversee investment of China's $1 trillion in foreign currency reserves. On March 9, 2011 yuan exchange with US dollar was $1.00 to 6.56 yuan.

[3] http://www.census.gov/indicator/www/ustrade.html

F. U.S. Dollar vs. UK Pound makes U.S. assets cheap for UK investors. U.S. Dollar is presently at $1.62 per £1.00 on March 9, 2011.

III. European Union (EU) – U.S. Relationship.

A. Trade.

a. The EU and the U.S. account for 40% of global trade in merchandise.

1. 20% of U.S. exports goes to the EU whereas 25% of EU exports goes to the U.S.
2. In 2007 U.S. exports to the EU totaled €180 billion ($234 billion) and imports from the EU totaled €260 billion ($338 billion).

b. Texas and the EU

1.10% of Texas' $150 billion international exports are to EU Member States ($15 billion).

2. In 2007, European investment supported 210,700 jobs[4] in Texas.

B. Investment.

a. EU-based companies are the largest foreign investors in 45 of the 50 states, including Texas.

1. European investment in Texas was over $50 billion.

2. 62% of the foreign direct investment in Texas is from EU Member States.

b. EU- U.S. Investment.

1. EU investment in 2007 into U.S: €112.6 billion ($146.38 billion).

2. U.S. investment in 2007 into EU: €144.5 billion ($187.8 billion)

[4] http://www.eabc.org/pdf/states/Texas.pdf

3. The “transatlantic workforce” consists of approximately 12-14 million people, half of which are Americans employed either directly or indirectly by EU companies

4. EU’s total investment stake in the U.S. economy today exceeds $1.4 trillion, accounting for nearly 75% of all foreign investment in the United States.

C. Services.

a. Amount of EU service exports into U.S. in 2007 : €139 billion ($180.7 billion)

b. Amount of U.S. service exports into EU in 2007: €127.9 billion ($166.27 billion)[5]

D. Conclusion: The European Union and the United States are the largest markets for one another’s trade and investment. The EU is the largest trade, investment and services partner of the US.

IV. U.S. Inbound Investment.

A. European private investment from Germany, The Netherlands, Belgium, France, etc., remains strong in office, land, warehouses, and ranches.

B. Mexico: Mexican investors own 10% of all residential homes in Northwest San Antonio, accounting for over 50,000 homes.

C. EU REITs & Regime

a. France: SIIC (Société d’Investissement Immobilier Cotée ; effective January 1,2003).
b. Germany: REIT-Aktien-gesell-schaft; effective January 1, 2007
c. Netherlands: Fiscall beleggings-int elling
d. UK: REIT (Real Estate Investment Trust); effective January 1, 2007

D. German global investment funds (e.g., Deutsche Bank Private Wealth Management and MFS Investment Management).

E. Australian REIT purchase retail malls and centers.

F. UK REIT (in force as of January 1. 2007) funds acquire U.S. malls, offices and U.S. REITs.

[5] http://ec.europa.eu/trade/issues/bilateral/countries/usa/index_en.htm

G. Asian Investment in the U.S.

a. More Government-funded finance vehicles in Asia, are based in China and Singapore.

b. Asian investors prefer West Coast cities such as San Francisco and Los Angeles, feeling more comfortable in and around a large Asian presence.

c. Government of Singapore – GIC Real Estate, owned by Government of Singapore, purchases hotels and office buildings for its own account. Temasek Holdings, the Singapore Government's successful investment agency, manages an $84 billion global portfolio of investments.

H. Middle East.

a. Arab nations earned an estimated $600 billion in 2008 from oil revenues, according to IMF.

b. Most Arab investors are individuals with short-term investment goals.

c. Most Arab investors moved their capital out of U.S. after September 11, 2001, and now focus on Saudi Arabia, Qatar, Dubai. Big banks are opening offices in Dubai, which has become, the Middle East financial Center.

d. Islamic Law prohibits interest on a straight loan; private-owned Islamic banks (not conventional banks) in Jordan, Egypt, Saudi Arabia, etc.

V. U.S. Outbound Investment.

A. Globalization of Real Estate Private Equity Funds - U.S. private equity funds invest in real estate in South Korea, Germany, U.K., Belgium, India, and China.

B. Germany – U.S. funds purchase commercial and residential real estate at prices cheaper than in other European countries. Merrill Lynch and Morgan Stanley are working with some large German developers in Germany to develop retail centers. Berlin is a popular market for foreign investors.

C. India – With a population of 1,188,310,000 and GDP growth of 6.1%, India's dominant position as an outsourcing and manufacturing center.

D. Euro Zone – Euro zone of 17 EU Member States out of the 27 members enjoy its fixed exchange rate and interest rates, is stable and attracts U.S. pension and institutional investors. Slovenia is the third newest Euro member on January 1, 2007, followed by Malta and Cypress on January 1, 2008. Slovakia entered the Euro zone on January 1, 2009.

E. EU – New members as of January 1, 2007 are Bulgaria and Romania, and are hot real estate markets for private investors seeking second homes and investment properties on the Black Sea, for example. These countries have lowest prices of the 27 EU Member States.

F. EU Corporate Tax- EU Member State corporate tax rates are now often lower than US rates and serve as an incentive to attract investment: Ireland 12.5%; Bulgaria 10%; Romania 16%; U.K. 28%; etc. (See Appendix 1: Corporate Tax Rates of EU Member States).

G. Luxembourg- International real estate funds are often listed on the Luxembourg stock market because it is less expensive to obtain a public listing. Plus Luxembourg has a favorable network of tax treaties.

H. Russia – Moscow is also a "hot: office market for investors and developers due to Russia's oil-driven real estate boom. Moscow is the fourth most expensive office market, with rents at $109.86 per sq. ft. Russia is in an accession process for membership in the World Trade Organization (WTO) in the very near future.

I. Asia Vietnam- No one is allowed to own land in Vietnam. Ownership laws are complex. Foreigners are limited to 50-year leases. With Vietnam's recent membership in World Trade Organization, one will likely see more U.S. trade and investment in Vietnam.

J. Mexico – Mexico has significant security and crime issues in Mexico affect foreign investment in Mexico at this time. Mexican resort properties are still a popular concept to U.S. developers. U.S. title insurance is available. If the property is within restricted zone of 50 kilometers of the Coast or 120 kilometers of the U.S. border, and is commercial, a foreign investor may purchase property through a Mexican corporation owned by foreign shareholders. Residential properties are held through 50-year trusts.

K. China – Fee simple ownership is not possible in China; only ownership permitted is usage right to the "bricks and mortar," which is restricted to 70 years for residential property, and to 40 years for commercial property. Land ownership is retained by the State.

VI. U.S. Reporting Requirements to Track Foreign Investment in the U.S., and other Special Topics.

A. U.S. Department of Agriculture requires reports of any foreign investment in forests, agriculture or ranch land within 90 days of purchase. The purchaser must file Form FSA-153, if foreign ownership is 10% or more, and the aggregate investment is 10 acres or more.

   a. Penalty for non-filing – 25% of the fair market value of land.

B. U.S. Department of Commerce.

   a. BE – 13 Report should be filed within 45 days of purchase if foreign ownership is 10% or more (direct or indirect) of any form of investment in real estate, oil and gas, companies, etc., within 45 days of purchase as an initial investment report when the investment is in a U.S. business enterprise with assets of over $3,000,000 and involves the acquisition of 200 acres or more of land.

   b. BE – 13C Exemption Claim should be filed if investment is under 200 acres and under $3,000,000, one files BE-13 C Exemption Claim.

   c. BE-14 should be filed by legal counsel, with the address of seller and buyer.

   d. BE-10 should be filed by U.S. Outbound Investment – U.S. companies annually and BE-11 quarterly for any investments over $15,000,000 re U.S. outbound investment.

C. U.S. Patriot Act and OFAC (Office of Foreign Asset Control's) reports to the U.S. Treasury Department. Reference to these Acts often seen in real estate loan documents stating that the party attests that they have not done business with certain foreign countries, and with specifically designated nationals. OFAC has been used by banks and other financial institutions to block transactions of drug dealers and other "criminals."

D. FIRPTA (Foreign Investment in Real Property Tax Act of 1980) withholding tax requires a buyer to withhold 10% of gross sales price when a foreign person sells or exchanges a U.S. real property interest. real property includes mine, well, or other natual depositsSuch withholding must be remitted to the IRS within 20 days after the date of transfer by using IRS Form 8288. Careful structuring is required to avoid FIRPTA withholding of 10% of proceeds in a sale or a seller's 1031 exchange. U.S. Emergency Economic Legislation in 2008 and 2009 contains an Amendment of FIRPTA (Section 3024). FIRPTA also applies to wind energy farms.

E. Mexico "Black List". Mexico has a "black list" of tax haven countries, which requires Mexicans with ownership of offshore companies in these countries to report to the Government of Mexico. Alternatives to avoid such Mexican reporting are to use companies in the Netherlands, New Zealand, or other less overt tax havens.

F. Balance Sheet. Foreign investors have a different form of balance sheet. When working with a French party, for example, their work week is 35 hours, with 5 week holiday, heavily regulated work force, expenses are high in France, and termination of employees is much more difficult and costly than in the U.S., which makes it more difficult for companies like Airbus, in France, as compared to Boeing in the US.

VII. Conclusion

The global financial crisis and world-wide recession has hit all sectors of the market across the world and across the board. The debt environment now requires more equity injection, greater personal recourse, smaller-sized loans, quality assets, etc., resulting in fewer loans. Despite the weakening U.S. Dollar rendering U.S. assets cheaper for foreign investors, limited foreign investment will take place in the U.S. in 2011, if only because foreign investors have problems of their own. The exceptions may be investment from China and India, excluding sensitive security areas. The recent billion dollar investment in Texas oil and gas in the Eagle Ford formation is an example of Chinese investment in the U.S. Foreign investors continue to look for special investment opportunities in the U.S. And although U.S. outbound investment in foreign countries was fashionable in 2008, it will be curtailed in 2010 and 2011.

Good investment-grade real estate is more and more difficult to acquire in the U.S., making markets such as Europe (particularly Central Europe), Asia (China, India, Japan, and South Korea), and Latin America (Brazil) attractive to real estate funds once the financial crisis is resolved. But certain investors nevertheless are buying more and more foreclosed real estate from banks.

For the time being Central Europe will likely experience radical declines in overall foreign investment in 2011. The French President is telling companies such as Renault and Peugot to pull out of Central Europe and bring jobs back to France. The same thing is happening in other countries and other sectors. Thus, while the European Union is fighting protectionism, nationalism remains a virus which spreads across the world in times of crisis. We see this exemplified in U.S. as wellwith the "Buy America" provisions.

As President Obama has said, "A crisis is an opportunity not to miss." It is clear that fewer transactions will be concluded in 2011, making this an ideal time to refine your business plan and to execute it when the economy starts to improve in the future.

I. Appendix 1: Corporate Tax Rates of EU Member Countries

EU Member Country	Corporate Tax Rate
Estonia	22%
Cyprus	10
Ireland	12.5
Latvia	15
Lithuania	15
Hungary	16
Poland	19
Slovakia	19
Austria	25
Slovenia	25
Czech Republic	24
Finland	26
Portugal	27.5
Sweden	28
United Kingdom	19 (basic) 30 (above 1.5m pound)
Denmark	25
Luxembourg	29.63
Belgium	33.99
Netherlands	25.5
Greece	29
Malta	35
Spain	35
France	33.33
Italy	37.25
Germany	15 (federal)