3 Tips For Doing Real Estate Deals With Foreign Investors

By Kaitlin Ugolik

As foreign investment in U.S. real estate continues to increase, experts say foreign investors, sellers and rival bidders alike should be wary of potential tax hurdles, differences in deal-making style and other cultural customs.

U.S. gateway markets like New York, Los Angeles and Washington stand out as "safe havens" for cash from less economically stable regions around the world, and the trend of foreign investors picking up trophy properties in these cities continues to grow.

But experts say that each party to such a transaction — the investor, any potential rival bidders and the seller — should carefully consider the unique challenges that arise when parties from different countries do a deal.

Here are three things to look out for when representing foreign investors or those working with them.

Foreign Investors: Prepare for Financing and Tax Trip-Ups

Attorneys representing the foreign investors looking to purchase U.S. property often face the challenge of working with clients who are unfamiliar with U.S. financing and tax structure, experts say.

Tax consequences can vary widely from client to client, based on their tax status in the U.S. and in their own country and on the tax treaties between the two. Foreign individuals not considered U.S. tax residents may be subject to withholding taxes, either as estimates of taxes that they might owe or as flat tax amounts, regardless of a deal's profitability.

In practice, this can mean a foreign investor is subject to tax on interest, leases or dividends, impacting how property ownership is structured, according to Dana Newman, a partner with Pillsbury Winthrop Shaw Pittman LLP.

Getting the money back out of the U.S. after it's invested in a property here without paying a disproportionate amount of sales tax can also be a major hurdle, Newman said.

"The overall issue is tax planning for a foreign investor to maximize their ability to get profits free of U.S. income taxes," she said.

Financing can be a problem for foreign investors as well, according to Wei Min Tan of New York buy-side condominium brokerage Rutenberg Realty, because U.S. banks lend to them at higher rates and require larger down payments.

"The key is to work with an experienced mortgage broker who has done many foreigner transactions," he said. "Just because a bank offers a foreigner mortgage program doesn't mean all of its bankers are experienced working with foreign buyers, because that's a niche market."

And on some deals, it may be necessary to explain concepts that U.S.-based clients take for granted, such as the fact that a trusted third party, and not a family member, should conduct the deal, and that a deal must be written and signed in order to be binding.

"It's important to explain this to foreign buyers because in many countries verbal agreements are binding," Tan said.

Sellers: Anticipate Differing Needs and Customs

Many of the foreign investors that are currently flocking to the U.S. are attracted to properties with specific characteristics, and they also may not have a traditional way of going about acquiring them.

Because of the tax issues mentioned above, many foreign investors have a strong preference for buying property through acquiring real estate investment trust shares, according to John Sullivan, a partner with DLA Piper.

"If you're a U.S. seller and you want to maximize the potential buyers for your property, if you hold it in a private REIT, you make buying that property more attractive for certain non-U.S. investors," Sullivan said.

This trend has led to an increase in the number of properties companies will put into private REITs even if there is no immediate benefit to the company, with an eye toward attracting foreign investors in the future, according to Sullivan.

When it comes to making the actual deal, experts say there are also some things that most U.S. investors might do as a matter of course that do not work for many foreign investors, such as setting the deal up through limited liability companies. More typically, non-U.S. investors prefer to use offshore corporations.

"For some non-U.S. investors, [using an LLC] has a very adverse tax result," Sullivan said.

Rival Bidders: Beware Foreign Investors' Pricing Power

The biggest issue for attorneys representing U.S.-based investors looking to compete with foreign investors on major deals — an increasingly common situation — is the disparity in price constraints, experts say.

While many U.S. investors look to purchase a property in an effort to make a quick return, either because they are investing through a fund with a short life or because their investors expect to see the benefit of the deal quickly for other reasons, a great number of the foreign investors currently doing deals in the U.S. are more concerned about stability than yields.

"They're willing to pay a premium, and many times they are the top bidder because they will pay more for a certain type of asset," said Manny Fishman, a shareholder with Buchalter Nemer PLC.

But there are ways to beat out foreign bidders, even if an investor can't offer the same high price.

Having a good track record of closing deals and being able to do so quickly, can put a U.S. investor ahead of a foreign rival, according to Fishman.

"A seller is looking for someone that will close and has a track record of closing, and sometimes the foreign investor is not that person, even with the higher price," he said.

--Editing by Kat Laskowski and Katherine Rautenberg.