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REAL ESTATE

# Foreign Investors Need a Roadmap As They Flock to New York Real Estate

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The continuing real estate boom has made New York City a magnet for foreign investors. The city's real estate market has recovered faster than expected from the 2008 financial crisis and is performing better than ever. With high returns available, it's no surprise that foreign capital is drawn to New York.

From a financial perspective, New York real estate may be a "safe haven" for overseas investment, but there are dangers, especially for individual foreign investors. While investing in real estate is always a complex undertaking, in New York the complexities are daunting, and overseas investment adds a new layer of considerations. Investors unfamiliar with the local scene can easily misstep, losing heavily, and may encounter legal stumbling blocks as well. Savvy foreign investors will seek the help of professionals who can provide guidance on assessing the choices and risks involved in New York real estate investment.

> ***The bottom line for foreign investors is this: Don't go it alone.***

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Foreign investors must first decide between active and passive participation. Passive participation is fairly straightforward. A foreign investor interested in obtaining a green card can invest in EB-5-qualified real estate projects with a minimum of a $500,000 cash investment. But as with most safe investment options, passive participation offers limited returns. Active investing offers higher returns – along with increased complexity and risk.

The first hurdle for active investors is the most basic: obtaining financing in order to leverage their cash at lower interest rates. For overseas investors, this is not straightforward. With no U.S. track record, lenders may not be confident in the business plan. In addition, foreign investors may not have sufficient U.S. assets to serve as collateral. Partnership with a U.S. investor may offer a smoother path to active investment – which means that investors need to consider how to structure the partnership, including tax and financial implications.

Foreign investors seeking to acquire either residential or commercial properties may find it difficult to evaluate the potential investment if they are not physically present here. That's why it's important to engage a team of experienced professionals to assist. For example, is the building financially sound? Many buildings receive a real estate tax break – what is the expiration date, and how much will taxes increase at that point? What are the tenant profiles? New York City rent restrictions are intricate, and investors may not realize how long it can take to convert rent-stabilized or rent-regulated properties to market rate.

Investors should also consider the

subsidies and concessions available for affordable housing. Navigating compliance requirements, such as tenant eligibility, is a process that even experienced local investors can find challenging.

An investor who acquires a commercial property may not grasp the complexities of commercial leases – either ignoring concessions that have not yet taken effect or failing to notice and act on revenue opportunities (e.g., if the tenant has agreed to reimburse the landlord for real estate taxes and utilities). Then there is the matter of environmental remediation – an investor in an acquired property may find he or she is responsible for cleanup and needs to hire an engineer to evaluate the soil or groundwater.

A foreign investor who opts for construction instead of acquisition has another range of factors to consider – for example, the weather (New York's winters can be long and harsh), which can affect materials used and worker productivity. More generally, labor laws, regulations and agreements will affect the construction project – everything from minimum wage to overtime to the potential for costly labor disputes.

Then there are tax issues. Each ownership structure (direct, via a U.S. corporation or via a foreign corporation) has tax implications. Foreign investors will also need to consider the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which imposes a U.S. tax on the disposition of U.S. real property or the entities that own it. Further, if the entity disposes of real property, there are also FIRPTA implications. Long-term capital gains are currently taxed at a maximum rate of 20 percent for individual investors and 35 percent for corporations. The tax is imposed via 10 percent U.S. withholding on the gross amount of the transaction. To reduce the withholding tax, the investor must submit a withholding certificate application reflecting the amount of the projected liability.

Given all these considerations, what should a foreign investor do? The answer is to form a good team: a broker to research and identify properties, an attorney to assist with closing and to review all contingencies, and an accounting professional with real estate and tax expertise who can advise on tax consequences both in the U.S. and in the investor's home country. They can perform due diligence and provide sound advice on what to expect during acquisition or construction, and while managing the property.

The bottom line for foreign investors: There are major opportunities to be found in New York properties. But don't go it alone.