

## REGULATORY REFORM

## Capital release

### New legislation could fundamentally change rules governing foreign investment in US real estate, unleashing billions of dollars of pent-up capital

Billions of dollars of foreign capital could be unleashed on US real estate markets if lawmakers back a new bill that would overhaul 30-year protectionist tax rules.

For the first time in decades, US legislators appear to be seriously reviewing the 1980 Foreign Investment in Real Property Tax Act (FIRPTA), after Democratic Representative Joseph Crowley introduced the Real Estate Revitalisation Act of 2010. The bill, which went before the House Ways and Means Committee at the end of January, would remove some of the tax barriers to foreign investment in US property currently imposed under FIRPTA, fundamentally changing the law.

Foreign real estate investors said the proposed legislation – dubbed the Crowley bill – would be more than just a minor tax tweak, and could lead to billions of additional capital investment in the US.

Originally intended as a tax to prevent farmland in America's heartland from being consumed wholesale by overseas investors, FIRPTA had outlived its purpose, according to MacLaine Kenan, executive director of real estate investment at Arcapita and recent chairman of the industry body, the Association of Foreign Investors in Real Estate. He is an enthusiastic “flag waver” for the repeal of FIRPTA. “This is a big deal, a very big deal,” he said. “We have been having this argument since the 1980s and now this topic is quite timely. Removing this barrier could unlock of billions extra in capital with modest impact to [the US] Treasury.”

FIRPTA requires sellers of real assets in the US, who are not resident aliens or US citizens, to allow buyers to withhold part of the gains from any disposition for taxable purposes. The tax is usually 10 percent of the sales price but can be up to 35 percent – and come on top of all other US taxes paid by the overseas investor. Although difficult to quantify, investors from all countries insist it does discourage investment in North American assets and places a significant barrier of entry to the US for many foreign investors.

Supporters accept the Crowley bill faces an uphill Congressional battle, needing to attach itself to another piece of legislation to stand any chance of successfully passing.

However, El Rosenheim, managing director of Ra'anana, Israel-based real estate investment firm Profimex, predicted roughly \$100 million in extra capital would be invested in US property by Israeli institutional investors alone if FIRPTA rules were eased. He was backed by Erwin Stouthamer, managing director and founder of Amsterdam-based Composition Capital Partners, who added: “There are a lot of uncertainties anyway in dealing with US real estate investments, such as inflation, currency risk, then on top of those you add FIRPTA. This bill could help lower that barrier.”



Crowley: unlocking investment

## INVESTOR RELATIONS

## Time for recalibration

### Regularly reviewing fund investment strategies could keep GP-LP relationships out of counselling

Being an LP in a closed-ended commingled fund isn't just about taking a passive position: limited partners should also proactively “recalibrate” relationships with their fund managers, especially when it comes to a vehicle's investment strategy.

With most GP-LP relationships lasting between eight to 10 years, Ernest Hunt, senior investment officer, real estate for the \$37.5 billion United Nations Joint Staff Pension Fund, has urged investors to fundamentally review a fund's investment strategy every few years to ensure continued “calibration” of interests.

Speaking at the annual winter forum of the Association of Foreign Investors in Real Estate last month, Hunt said investing in private equity real estate funds was “less than marriage but more than dating”, requiring “from time to time ... a recalibration [of] your relationship”.

“An investment strategy from two years ago and today are not necessarily going to be the same thing. Those vehicles have to be able to breathe and be flexible over that eight to 10-year life, especially in the investment period,” Hunt told delegates at the New York conference.

The UNJSPF invests in roughly 44 commingled property funds, with Hunt saying LPs had to develop relationships where LPs could encourage GPs to “start from scratch” if the investment strategy wasn't suitable for market conditions. “You have got to have relationships where you can say if we need to rethink the investment strategy, we have to rethink the investment strategy.”

Hunt added: “If you are getting out of calibration with LPs, which can happen over a long period of time, it's going to lead to problems. I'm a big believer in recalibrating that interest from time to time.”