Congress Eases Curbs on Foreign Real-Estate Investors

Move could bring billions of dollars of additional investment into an already-robust market for office buildings, apartments and malls

Commercial-property prices, particularly in major U.S. cities, are at record highs. PHOTO: MICHAEL NAGLE/BLOOMBERG NEWS

By

Eliot Brown

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Ever since the downturn, key players in the commercial real-estate industry have been trying to convince lawmakers to reverse a 1980s law that sought to curb foreign investors from scooping up U.S. property, saying it was a relic of a more protectionist era that discouraged investment.

On Friday, the industry finally persevered, as the broad spending and tax measures passed by Congress relaxed the law in a move some expect to bring billions of dollars of additional foreign investment into an already-robust market for office buildings, apartments and malls across the country.

The law, known as the Foreign Investment in Real Property Tax Act, subjects foreign investors to income tax when they sell U.S. property. It was initially passed in 1980, a time when there were fears that foreign investors including the Japanese might buy up large swaths of the country and its farmland.

The law is "a vestige of a long time ago," said Kenneth Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at University of California, Berkeley.

The changes in the omnibus spending package allow foreign pension funds—which already buy tens of billions of dollars of commercial property a year—to sell property without having to pay taxes along the way. In addition, foreign investors will be allowed to own as much as 10% of a publicly traded real-estate company before facing additional taxes, up from the 5% allowed under the prior law.

The two provisions on foreign investment "might increase it $20 or $30 billion a year—which is significant, but not overwhelmingly large," Mr. Rosen said.

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Commercial-property prices, particularly in major cities, are at record highs, propped up in part by the growing ranks of foreign investors that are targeting the country despite the tax law. Foreign pension funds are some of the largest sources of international money that comes into the U.S., particularly from Canada, as giant public pension funds in the country have been bulking up on property in the U.S. Many of those funds, though, simply buy 49% stakes in buildings, a move that avoids the tax but requires they share control with other investors.

The legislation—a priority of the Real Estate Roundtable, a main industry trade group—has never been particularly controversial. But lawmakers have stalled over how to deal with the lost tax revenue that would come from a change, and Congress hasn't passed many large tax bills in recent years. The changes in the legislation passed last week are estimated to cost $4.25 billion over 10 years.

"Despite broad support to do something here, the process has not accommodated these kinds of bills," said Jeffrey DeBoer, chief executive of the Real Estate Roundtable.

But the broader tax and spending legislation contained other measures affecting real estate that offset the cost, making the job easier, said Rep. Kevin Brady (R., Texas), an architect of the changes. The most prominent was a provision that restricts the ability of companies to spin off their property holdings into real estate investment trusts, which don't pay income tax. That provision is estimated to raise $1.9 billion over 10 years.

"We're just pleased to be successful," Mr. Brady said.

—Liam Pleven contributed to this article.

Write to Eliot Brown at eliot.brown@wsj.com

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