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Transnational Conveyancing

Barlow Burke
American University Washington College of Law, bburke@wcl.american.edu

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In recent years there has been a substantial increase in foreign direct investment in United States real property. It is not yet clear what effect the investment will have upon this country. Presumably it will aid the American economy, perhaps in the form of an increased flow of capital. Notwithstanding these positive effects, however, Americans are not likely to relish the idea of having aliens control significant amounts of domestic real estate. This article will examine the countervailing considerations that exist regarding foreign investments. It will discuss the right of foreign nationals to hold real property in the United States, explore the nature and extent of foreign direct investment in this country, and touch upon some of the various problems involved for both aliens and Americans who want to achieve more foreign investment in United States land. In addition, it will analyze some consequences of this investment for America as a whole and for its financial community in particular.

I. The Property Rights of Aliens and Native Peoples

A. The Common Law

At common law, aliens could not take a freehold interest in real property since they were considered not to have "seisin," or possession responsive to civil authority. The United States, however,
grounded its society on the premise that citizenship depended not on the holding of a blood relationship with past citizens, but rather on an individual's declaration of loyalty to America and on a renunciation of his past allegiances. This led to a modification of the early common law doctrines so that aliens, although not permitted to take land by statutory inheritance or operation of law, could acquire land by a conveyance. Still, the alien purchaser was without the "capacity to hold against the state."

At present, the common law prohibitions regarding the right of foreigners to own land survive only when and if the civil authorities choose to exercise preemptive powers. Until the alien's title is so divested, he has complete dominion over lands he holds. The evolution of these principles is not surprising. America in its formative years was a nation wishing to encourage immigration. Legal disabilities pertaining to alien landholding were removed in some states when the jurisdictions were initially being settled; legislatures encouraged the immigration of aliens by enacting statutes allowing some of them to hold indefeasible titles. After the states had been settled,

sponsiveness to governmental authority because, by definition, a freehold gave seisin to its possessor. G. SHARSWOOD & H. BUDD, 1 LEADING CASES IN THE LAW OF REAL PROPERTY 501 (1883) [hereinafter cited as SHARSWOOD & BUDD].

2. See Inglis v. Sailors' Snug Harbor, 28 U.S. (3 Pet.) 99 (1829) (individual, who was born before July 4, 1776, lived in New York under British occupation, and then left New York with British troops to live in Canada, was an alien and hence disabled from inheriting land). See also SHARSWOOD & BUDD, supra note 1, at 497-98, which states the rules under which American colonials were determined to have elected United States citizenship.

An early twentieth century commentator noted that the inability of aliens to acquire realty through descent was apparently a vestige of the idea that rights of citizenship hinged on the determination of bloodlines. As the alien could not take by descent, he was regarded as having no inheritable blood. If he died, the land went immediately to the State and a title would not be traced through him. Thus if a citizen died, leaving his only relative a grandson, also a citizen, who was the son of an alien, he could not take.


3. 3 AM. JUR. 2d Aliens and Citizens § 13 (1962) (the alien's title may be divested by the sovereign).

4. Id.

5. See L. FRIEDMAN, A HISTORY OF AMERICAN LAW 209-10 (1973):

[M]any people played the land market, as their descendants played the stock market; an expanding population meant rising prices of land; this implied an open-door policy for aliens, and alien investment. The absolute disability of aliens faded into local compromises. As early as 1704, a South Carolina act, praising resident aliens for 'their industry, frugality and sobriety,' for their 'loyal and peaceable' behavior, pointed out that they had acquired 'such plentiful estates as hath given this Colony
However, these statutory privileges were sometimes revoked.\textsuperscript{6}

Generally, absent state common law or statutory law to the contrary, an alien in America was able to buy and sell real property by purchase, grant, conveyance, or devise. Once he owned the property, a foreigner could defeat escheat (i.e., reversion to the state) by becoming a citizen before the state's power to preempt his right of ownership was exercised and perfected by a final judicial decree.\textsuperscript{7} Aliens could also prevail against private parties asserting the preemptive rights which were the prerogative of the state alone.\textsuperscript{8}

Today, the right of an alien to hold property may be controlled by state statute.\textsuperscript{9} Where aliens' property rights are involved, as with conveyancing generally, state law controls unless a federal interest is

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\textit{Id.} (citations omitted). \textit{See also} 3 AM. JUR. 2d Aliens and Citizens § 30 (1962).

6. Two successive statutes regarding aliens and their right to own real estate in the District of Columbia at the turn of the 19th and 20th centuries are illustrative. Md. Pub. L., § 6 (1791), an Act of the State of Maryland concerning the Territory of Columbia and the City of Washington, \textit{cited in} W. TINDALL, ORIGIN AND GOVERNMENT OF THE DISTRICT OF COLUMBIA 16 (1907), provided that:

Any foreigner may, by deed or will hereafter to be made, take and hold lands within that part of the said Territory which lies within this State in the same manner as if he were a citizen of this State; and the same lands may be conveyed by him and transmitted to and inherited by his heirs or relations as if he and they were citizens of this State; Provided, That no foreigner shall, in virtue thereof, be entitled to any further privilege of a citizen.

\textit{Id.} The objective of this legislation was stated in its preamble: "that allowing foreigners to hold land within the said Territory will greatly contribute to the improvement and population thereof." \textit{Id.}

A little over a hundred years later, however, legislation expressed a different view towards alien land ownership:

It shall be unlawful for any person not a citizen of the United States or who has not lawfully declared his intention to become such citizen, or for any corporation not created by or under the laws of the United States or of some State or Territory of the United States, to hereafter acquire and own real estate, or any interest therein, in the District of Columbia, except such as may be acquired by inheritance.


9. The validity of state regulation of the property rights of aliens was sometimes founded upon the legal maxim that the law of the situs controls a question of land titles in an interstate or multijurisdictional transaction. 3 AM. JUR. 2d Aliens and Citizens § 15 (1962).
asserted. States have allowed aliens to hold indefeasible interests in
realty taken by descent, and have permitted tracing titles through
aliens. Restrictions, however, may be imposed upon the right of
aliens to hold real property. States may, for example, require aliens
to express an intent to become naturalized citizens as a condition to
acquiring land, or may restrict foreign landholding to specific loca-
tions. Nevertheless, any restrictions which the states might impose
must not contravene the equal protection clause of the fourteenth
amendment.

In individual conveyances, a policy of permitting aliens to hold
property has been given effect through more specific rules of law.
Unless a statute regarding alien rights has been violated, neither
party to a land contract or deed has the right to rescind on the

10. See, e.g., People v. Compagnie Generale Transatlantique, 107 U.S. 59 (1882), in
which the Court invalidated a New York statute imposing a tax on every alien passenger
arriving in the port of New York by vessel from a foreign country. See also SHARSWOOD
Co., 25 Vt. 433 (1853), in which it was stated: "the right to interfere with aliens holding
real estate in this country... belongs to the national, and not to the State sovereignty." Id. at 437-38.
11. See note 2 supra.
12. See, e.g., ILL. REV. STAT. ch. 6, §§ 1-2 (1975) (alien may purchase land, but must
dispose of it within six years); IOWA CONST. art. 1, § 22 (1857) (resident aliens may
acquire land without restrictions only within city or town limits and may buy only 640
acres beyond such limits).
(1974).
14. See, e.g., Semrad v. Semrad, 170 Neb. 911, 104 N.W.2d 338 (1960), applying a
Nebraska law limiting ownership of land by nonresident aliens to parcels within cities
or villages or 3 miles thereof.
15. See, e.g., Oyama v. California, 332 U.S. 633 (1948) (California Alien Land Act, as
applied to effect an escheat to the state of land recorded in name of a minor American
citizen because the land had been paid for by a Japanese alien, constituted a depriva-
tion of equal protection of the laws); Frick v. Webb, 263 U.S. 326 (1923) (upheld section
of California Alien Land Act which restricted manner in which aliens could acquire
stock in corporations engaged in agricultural land transactions); Porterfield v. Webb, 263
U.S. 225 (1923) (California Alien Land Act, by allowing aliens eligible to become
United States citizens to enjoy certain real property rights, while permitting other aliens
to exercise these rights only as prescribed by treaties, does not violate equal protection
clause). See also Terrace v. Thompson, 263 U.S. 197 (1923); Toop v. Ulysses Land Co.,

There is currently a judicial trend towards closer scrutiny of laws which discriminate
against resident aliens. Generally, states are now required to show they have a compell-
ing interest, rather than merely a rational basis, for such laws. See, e.g., In re Griffiths,
413 U.S. 717 (1973) (holding restrictions on bar membership as to resident aliens un-
constitutional); Sugarman v. Dougall, 413 U.S. 634 (1973) (holding blanket disqualification
of aliens from public employment in New York State government unconstitutional);
Graham v. Richardson, 403 U.S. 365 (1971) (granting welfare benefits to resident aliens).
ground that the other was an alien.\textsuperscript{16} Even when a statutory violation has occurred, the alien can recover any deposit or payments if he entered the transaction innocently.\textsuperscript{17} Also, it should be noted that when a purchaser acquires title from an alien ineligible to become a United States citizen, the validity of the purchaser's title is a matter which was in dispute for much of the nineteenth century. The third party purchaser's title has been upheld in a majority of cases,\textsuperscript{18} although the determination has often turned on the alien’s good faith during his original acquisition.\textsuperscript{19}

Native American “aliens” were governed by different rules than were applied to foreign nationals. In some states, absent statute, an Indian had no capacity to convey realty inter vivos.\textsuperscript{20} American real property laws did little to help Indian tribes impede the oncoming wave of settlers. The tribes’ title did not take precedence over the location of Treasury warrants\textsuperscript{21} or townsites\textsuperscript{22} on tribal lands, even when the white settlements came before the cession of the Indian title to the United States. Although the federal government had a duty to extinguish Indian claims in lands under government patent,\textsuperscript{23} this was apparently a mere formality, because in all instances the United States had superior title;\textsuperscript{24} it owned the fee before cession and could convey a patent subject to it.\textsuperscript{25} There appeared to be a

\textsuperscript{16} Hepburn v. Dunlop & Co., 14 U.S. (1 Wheat.) 179, 196 (1816). The Court intimated, however, without deciding, that the incapacity of the purchaser to hold land might be a reason for denying specific performance. \textit{Id. See also} Sharswood & Budd, \textit{supra} note 1, at 501-03.

\textsuperscript{17} 3 AM. JUR. 2d Aliens and Citizens § 16 (1962).

\textsuperscript{18} \textit{See}, \textit{e.g.}, Fairfax’s Devisee v. Hunter’s Lessee, 11 U.S. (7 Cranch) 603, 618 (1813) (alien may convey defeasible estate); Scanlan v. Wright, 30 Mass. (13 Pick.) 523, 529 (1833) (conveyance by alien vests estate in grantee, subject only to being defeated by government); Oregon Mortg. Co. v. Carstens, 16 Wash. 165, 168, 47 P. 421, 423 (1896) (deed of land by alien to person entitled to hold it, if made before the state undertakes to have the original conveyance set aside, transfers good title).

\textsuperscript{19} \textit{See generally} 3 C.J.S. 2d Aliens §§ 16-30 (1973).

\textsuperscript{20} Murrey v. Wooden, 17 Wend. 531 (N.Y. Sup. Ct. 1837); \textit{contra}, Colvord v. Monroe, 63 N.C. 288 (1869). \textit{Cf.} United States v. Ritchie, 58 U.S. 524 (1854), in which an Indian was held competent to convey real property. The land in question was in a section of California that had been under Mexican control. The Indian grantor had been a Mexican citizen at the time of the grant to him. \textit{Id.} at 540.

\textsuperscript{21} \textit{See} Marshall v. Clark, 8 Va. (4 Call) 268 (1791).

\textsuperscript{22} \textit{See} Village of Mankato v. Meagher, 17 Minn. 243 (1882) (court cannot invalidate the title of one claiming by virtue of settlement and occupancy of “town-site,” regardless of fact that settlement was prior to extinguishment of Indian title).

\textsuperscript{23} \textit{See} Veeder v. Guppy, 3 Wis. 502, 522 (1854).

\textsuperscript{24} Johnson v. McIntosch, 21 U.S. (8 Wheat.) 543 (1823).

\textsuperscript{25} Gaines v. Hale, 26 Ark. 168 (1870) (the United States holds the fee simple to the lands occupied by the Indian tribes and may disregard their right of occupancy and convey an unencumbered title in fee simple).
preference for the "settled" uses of land as opposed to the Indians' nomadic use,\textsuperscript{26} and since cession was the only method of sale open to the tribes\textsuperscript{27} under applicable statutes, native Americans could only convey their lands by one-sided if not forced sales.\textsuperscript{28}

**B. Federal Treaties and State Powers**

From the beginning of its economic development, the United States was a magnet for foreign capital. The Jamestown Colony was a venture financed by a private company. The Louisiana Purchase was closed with loans from British and Dutch interests. The Erie Canal was partially financed by British loans. The Bank of the United States, state banks, turnpikes, bridges, and railroads—indeed most of the financial and transportation infrastructure of our economy—were built with foreign money.\textsuperscript{29}

This influx of foreign capital often served as a course of conflict between federal treaties and state law. An alien's right to hold real


Americans in the nineteenth century were too idealistic to justify their conquests merely by force of arms, and they turned instead to an argument that was based on the highest use of the land. The rationale for dispossessing the Mexican landholders was that they were slow to accept change and were thus inefficient in their cultivation of the land; Yankee entrepreneurial ability would render the land much more productive. The young Richard Henry Dana, describing the magnificent ranches of California in the 1830's often stimulated his imagination with the thought of how bountiful this land could be if only hustling Yankees were in charge. Americans took even greater pains to develop this 'higher use' rationale against the Indians. In contemporary discussions and court cases involving Americans' right to displace the Indians, the issue was usually presented as an irreconcilable confrontation between a tribe of nomadic hunters and a society of husbandmen, with the husbandmen winning simply because they were clearly a more advanced form of social organization. The crucial center of the justification for taking this land from its present holders was not that American social practices were superior to those of the Mexicans and Indians, but rather that farming and industry were more productive uses of the land than ranching and hunting.

\textit{Id.}

\textsuperscript{27} See generally Osage Nation of Indians v. United States, 97 F. Supp. 381 (Ct. Cl. 1951).

\textsuperscript{28} See Holden v. Joy, 84 U.S. (17 Wall.) 211 (1872). The Supreme Court noted that since the early discoverers arrived in America, Indians could sell [land] to the government of the discoverer, but . . . could not sell to any other governments or their subjects, as the government of the discoverer acquired, by virtue of their discovery, the exclusive preemption right to purchase, and the right to exclude the subjects of all other governments, and even their own, from acquiring title to the lands.

\textit{Id.} at 244.

property was early found to be a proper subject for the treaty-making
powers of the federal government. Once made and ratified, a treaty becomes the law of the land and the courts are without power to qualify it. Where a treaty and state law conflict, state law must yield to both the supremacy clause and the foreign relations power of the federal government as established in the United States Constitution. It should be noted, however, that for an alien to come under the auspices of a treaty he must be a subject of the country with which the United States concluded the treaty, and must plead the treaty as a defense to state law.

Overall, while some restrictions have been placed on foreigners who have wished to own real property in the United States, state land laws, whether subject to a federal treaty or not, have not provided significant barriers to the real estate interests of such aliens. In the past decade, this absence of restriction has facilitated the growth of foreign investment in America.

II. INVESTMENT MOTIVATIONS, OBJECTIVES, AND STRATEGIES

A. Investment Motivations

The number and amount of investments abroad by United States firms far exceed the direct investment by all foreigners and foreign entities in the United States. Nevertheless, as indicated in the introduction to this article, in recent years there has been a dramatic


31. An alien can be held subject to a treaty from the date of its ratification. Insofar as the rights of foreign governments are concerned, once ratified a treaty’s effectiveness relates back to the date of its signing. But where individual rights are at stake, there is no relation back to the date of signing; the treaty is effective only from the date of ratification. The rationale behind this distinction is that whereas governments are put on notice by the signing of a treaty that such treaty may soon take effect, the individual citizen often has no means of becoming aware of the existence of a treaty until it is officially ratified and proclaimed. See Haver v. Yaker, 76 U.S. (9 Wall.) 32 (1869).

32. 3 AM. JUR. 2d Aliens and Citizens § 14 (1962).

33. Id.

34. See Henderson v. Tennessee, 51 U.S. (10 How.) 311 (1850). The Court ruled that if, in a suit for ejectment, the defendant claims under a title to the land pursuant to a United States treaty, and a state court decides against the defendant, the Supreme Court has jurisdiction to hear the case. Id. at 318-19. See also Owings v. Norwood’s Lessee, 9 U.S. (5 Cranch) 344 (1809).

35. See Foreign Investment in the United States: Hearings Before the Subcomm. on Foreign Economic Policy of the House Comm. on Foreign Affairs, 93d Cong., 2d Sess., at 204 (Jan. 29, Feb. 5, 21, 1974) [hereinafter cited as Foreign Investment Hearings].
increase in the volume of direct foreign investment in this country. Favorable currency exchange rates, a growing sophistication on the part of foreign firms desiring access to the United States' markets, and investors' uncertainty over future United States trade policies have been among some of the factors which have spurred this trend.

A large build-up of American dollar reserves held abroad has also accelerated this investment. The tremendous credit built up during World War II in international accounts in favor of Americans has apparently dwindled over the last thirty years. A factor concomitant with the dwindling balances has been foreign direct investment in the United States which has drawn on these accumulated reserves of American dollars held abroad. Alternative investments for foreigners have become more expensive as the dollar has been discounted and transaction costs involved in converting dollars into other currencies have risen.

36. Direct investment generally takes place in two different contexts. When foreigners own a significant number of equity shares of a firm incorporated in the United States so as to give them an "important voice in management," this constitutes direct investment. It also occurs when a foreign business entity not incorporated in this country conducts business here, either through a wholly owned branch or a subsidiary or affiliate which is incorporated in the United States. Id. at 203.

37. Whereas new direct foreign investment in the United States had averaged approximately $675 million per year between 1962 and 1972, in 1973, it climbed to over $2 billion. Id. at 1 (remarks of Representative Culver).

The United Kingdom and Canada are the source of over half of the foreign investment in the United States. Id. at 205, 210 (table 5). Only a small part of this investment, however, is in real property. Id. at 211 (table 6). Reports from the Japanese government, which monitors the flow of money out of that country, indicate that from April 1972 to March 1973, in 225 government approved transactions, Japanese businessmen invested $47 million in United States realty. Most of this realty was located in Hawaii and southern California. Eighty per cent of the investors purchased homes, apartments, or condominiums. Id. at 41 (testimony of N. Stitt).

It is surprisingly difficult to obtain data to substantiate this trend. The Congressional report cautions that "statistics concerning international investment are tenuous. In many countries they are not collected at all. U.S. statistics are better than those of other countries but cannot be regarded as complete." Id. at 204. Moreover, the existing data does not always reveal the true nationality of the foreign investors; for example, a British firm may be controlled by nationals of other countries. For a general discussion of some of the problems resulting from foreign investment in the United States, see Brodkey, Foreigners Intrigued by U.S. Real Estate, GUARANTOR, Winter, 1976, at 12.

38. The recent devaluation of the American dollar is one factor which has led to the growth of foreign investment in the United States. Such a devaluation makes American currency cheap in relation to the currencies of foreign countries. As a consequence American goods and services, as well as securities, become relatively less expensive than the foreign equivalents. This disequilibrium accounts for inflows of foreign capital to purchase such goods, services, and securities, thus increasing foreign investment.


40. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 1975 at 760 (Fig. XLVI), 764 (table No. 1205), 777 (table No. 1220).
At the present time foreign investors may be attracted to investment in American real property because real property in the United States is inexpensive compared to other countries, and provides a stable, relatively nondepreciable asset. Investment in many foreign countries is often plagued by inflation, political instability, or high discounts in international trade. The American investment market, by contrast, is characterized by relatively low rates of inflation, political stability, a tradition of free enterprise in real estate, favorable exchange rates for converting foreign currency to United States dollars, and the long-term strength of the dollar. Moreover, land ownership is a particularly attractive mode of direct investment in this country, because it involves control of a capital residual not easily affected by economic or political change.

Some individual West European investors also seem to be motivated by their fears of political instability in Western Europe in the coming decades, particularly when and if the American military leaves. These people may seek a property interest in a democracy more stable than any in Western Europe. Whether or not this type of motive has a destabilizing effect on Western Europe is an interesting question for Americans encouraging this investment. Similar questions could be raised about British investors, some of whom may fear the further economic collapse of their homeland.

Another attraction for foreign investors are American zoning laws. They are often less restrictive than those found abroad. The enticement of greater profit potential because of the lesser restrictions has appealed to a number of foreigners. For example, restrictive land use controls in Canada have driven Canadians across the border to invest in American recreational properties.

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42. Foreign Investment Hearings, supra note 35, at 210.
43. In addition, some investors may seek the future benefits to be gained from investment in relatively stable American markets in food, fiber, and natural resources. See Rothschild, A Reporter at Large: Short Term, Long Term, New Yorker, May 26, 1975, at 40, 43.
44. This is especially true of British Columbians, who have increasingly invested in land in the state of Washington. A British Columbian land use official, William Lane, has stated:
   You have half of our population living in the southwest corner of the province . . . and a twenty-year history of land-use controls. Across the border [in the United States] you have more habitable land, with a history of little or no land use control. Of course there’s a certain temptation when you put the two side by side . . . . [Furthermore,] interest rates are 1 to 3 percent lower in Washington, and land is cheaper, so people will continue to come across the border.
It should be noted that the reinvestment of money earned by foreign businesses in the United States accounts for a large part of the current increase in foreign direct investment.\textsuperscript{45} Large firms in concentrated industries,\textsuperscript{46} whose land purchases are small in relation to their industrial acquisitions, account for much of this growth.\textsuperscript{47} These American based foreign businesses may have originally invested for any of the previously described investment motivations. With foreign investment in the United States on the rise, their decision to reinvest may reflect a reaffirmation of their original motivation, or it may reflect one of the more current investment attractions which motivates other currently foreign based investors.

B. Investment Objectives and Strategies

Whatever their motivation for investment or reinvestment may have been, foreigners have tended to hold similar investment objectives. One commentator has summarized their criteria as including "well-established present property value, likely substantial appreciation over the next 3-5 years and, in most cases, current income from the property sufficient to meet interest and operating expenses together with a return of 6-10\% per annum on invested capital."\textsuperscript{48}

This general statement of investors' objectives carries significant implications about the kind of strategy the foreign investor uses to achieve these objectives.\textsuperscript{49} Several years ago information concerning the potential of real estate markets in the United States was not readily available. Foreign investors' only means of determining the investment potential of a region was comparison of regional and national statistics. Those regions with high rates of appreciation in realty value attracted much initial interest because foreign investors wanted to place money in regions where Americans had found investment profitable. The Southeast,\textsuperscript{50} particularly the Atlanta metropolitan area

\begin{itemize}
  \item \textsuperscript{45} Reinvested earnings accounted for 61 per cent of the growth in foreign direct investment between 1962 and 1972. \textit{Id.} at 204-05.
  \item \textsuperscript{46} Such firms have the managerial and technological expertise necessary to compete in a foreign market. \textit{Id.} at 219-20.
  \item \textsuperscript{47} \textit{Id.} at 219.
  \item \textsuperscript{48} \textit{Forry, Planning Investments from Abroad in United States Real Estate, 9 INT'L LAW.} 239 (1974) [hereinafter cited as \textit{Forry}].
  \item \textsuperscript{49} The following discussion of investment strategies is based on confidential interview memoranda, on file with author at the American University Law School.
  \item \textsuperscript{50} Of course, investment attraction to the Southeast has not abated. The region has experienced a continued high appreciation in realty values. It has also continued its tradition of financing a great deal of economic development with out-of-state capital, and has been aggressively recruiting foreign money. Middle Eastern investors have focused their purchases in the Southeastern United States. \textit{See, e.g.}, \textit{Foreign Investment
and coastal land, was the center of attention. Another advantage of investment in these areas was that private reporting services provided information on recent land prices in Atlanta and Orlando, Florida, so that investors could readily determine if the selling price was indeed comparable to the market rate. These patterns indicate that the availability of information is an important factor in encouraging foreign investment.

Although foreign investors sought to emphasize proven investments in tested markets\textsuperscript{51} in this country, they failed to understand that the largest appreciation in value in percentage terms does not always produce the largest absolute growth. Relying on percentage figures can lead investors to place their money in areas that do not provide maximum profit and therefore fail to serve their goals. Those early investors who sought stable present value as well as maximum profit rarely participated in construction and development which might have provided this maximum profit. Rather, they relied on percentage figures and therefore invested in already developed land.

In general, in determining whether an investment in already developed land is attractive, an investor might look at a ratio of pur-

\textsuperscript{51} See note 50 and accompanying text \textit{supra}. Japanese investment has also tended to cluster in particular areas: for example, Hawaii resort properties, tourist facilities in California, and in natural resources on the Pacific and Gulf Coasts, and in Alaska. See, \textit{e.g.}, Foreign Investment Inside USA Report 2, Jan. 15, 1975 (Alaska, Hawaii, and Guam); Foreign Investment Inside USA Report 5, Dec. 15, 1974 (Hawaii, Gulf Coast, and Alaska). \textit{See also} Cannon, \textit{Increasing Investment in U.S. by Foreigners Irks Many in Congress}, Wall St. J., Jan. 22, 1974, at 1, col. 6 (Hawaii).

Japanese purchases around Japanese-American centers within the United States tend to support the Japanese tourist industry in the United States. One Japanese realty investment consortium has built a Tokyo-styled hotel in the “Little Tokyo” urban renewal section of Los Angeles. Foreign Investment Inside USA Report 5, Nov. 15, 1974. An interesting question which arises with regard to this project is whether aliens may participate in the federal subsidy programs for urban developers. See, \textit{e.g.}, Ramos v. United States Civil Serv. Comm’n, 376 F. Supp. 361 (1974), holding that federal disaster loans are available to aliens, thus indicating that this question may be answered in the affirmative.

The clustering of Japanese urban investments has, however, made them highly visible, sometimes stirring local resentment. This is particularly true in Hawaii, where Japanese demand for resort properties has allegedly driven up prices. See Foreign Investment Inside USA Report 5, Sept. 15, 1975; Foreign Investment Inside USA Report 6-7, Dec. 17, 1973. This resentment of locals has forced some recent decentralization of these activities. Foreign Investment Inside USA Report 5, Dec. 15, 1974. In one instance, Japan’s largest bank bought several Hawaiian golf courses, and then announced that at least two of them would be closed to the public. After a local outcry, the courses were once again opened to the public. \textit{Id.}
chase price to replacement cost. In this context, when the purchase price of a building is lower than what it would cost to replace the building, that building would be an attractive investment.

This same analysis of purchase price to replacement cost may also account for a recent increase in the assumption of existing mortgages by purchasers. Recent increases in interest rates and loan charges make the purchase cost of new mortgages very high. Therefore, the same purchase price to replacement cost criteria are at work: the transaction costs involved in acquiring the mortgage—by a purchase of the underlying equity—are low compared to the cost of replacing the older mortgage in the present capital market. This may be one reason why few foreign investors request loans for new mortgages in the present capital market.

Another strategy of foreigners involves investment in commercial property. Most investors seek to place their money in this type of property and most desire to obtain a fee simple title rather than a long-term leasehold. On the whole, according to one investment advisor, the state of the market is that foreign investors have too much money to exchange for the few types of properties they view as desirable. This is so, in part, because few investors are advised to invest in residential rental properties. Also, with the exception of advisors in two New York City commercial banks, few advisors have recommended raw, unimproved land as an investment.

A geographic strategy which may be expected in the future is decentralization of investment by foreign nationals away from high-growth regions of the country such as the Southwest. The movement of investors' funds to mid-size metropolitan areas that have not overbuilt their commercial markets are believed to present attractive investment possibilities. Cities like Columbus, Ohio, Indianapolis, Indiana, and Rochester, New York, are examples of such areas. Minneapolis, Minnesota and Vancouver, British Columbia are cities which still have some, although perhaps less, investment potential.

Overall, foreign investment in realty has been primarily attracted to cities and regions of the United States with an established growth ethic and few land use controls. This movement of foreign funds

52. An exception to this trend is one Dutch syndicate which has specialized in mid-South apartment houses. See, e.g., Foreign Investment Inside USA Report 5, Aug. 15, 1974 (Memphis and Atlanta).

53. See generally Trillin, U.S. Journal: Charleston, South Carolina: The Blacks, the Jews, and the Bird-Lovers, NEW YORKER, May 12, 1975, at 101 (a coalition of blacks, Jews, and environmentalists unsuccessfully opposed a zoning change on an offshore island held by Arab investors); Washington Post, April 27, 1976 § C, at 7, col. 4 (con-
into United States real estate has reflected some differences in land markets existing in the country. Much of it has moved into regions with high appreciations in realty values when expressed in percentages rather than dollar amounts.

III. THE SETTLEMENT PROCESS

The acquisition of American real property, for foreign investors and others, is basically a four-step process: finding the property, executing a contract to purchase it, financing the purchase, and closing the transaction.\(^{54}\) When aliens are concerned, however, this four-step process, as well as the process of choosing a business entity to acquire the property, involves complications which create additional problems for both alien and American parties. This section of the article will discuss some of these problems.

To begin, gaining entry into the United States may in itself be a problem. The immigration laws have provisions directly limiting entry of present or potential investors in United States enterprises. Such individuals are classified not as "immigrants,"\(^{55}\) but rather are subject to the stricter regulations governing "nonimmigrant aliens." The nonimmigrant alien investor is defined as a person entitled to enter the United States under a treaty solely to carry on substantial trade, principally between the United States and the foreign state of which he is a national; or (ii) solely to develop and direct the operations of an enterprise in which he has invested, or of an enterprise in which he is actively in the process of investing, a substantial amount of capital . . . .\(^{56}\)

Thus the nonimmigrant alien investor must carry on substantial trade or invest substantial capital in order to enter the United States. He must qualify for a "treaty investor" visa.\(^{57}\) This visa is available pur-
suant to bilateral agreement on reciprocity for United States citizens and imposes no maximum permissible period for staying in the country.\textsuperscript{58}

A. Brokers, Finders, and Others

Despite the difficulties created for potential investors who wish to enter the United States, inability to gain entry may not be a major problem for them. It is unlikely that many investors would come in person to locate a suitable property. Rather, intermediaries are often used. The parties to a domestic real estate transaction normally use the services of a real estate broker. In the case of nonresident foreign investors, the broker's work is divided in two and is performed by finders and brokers.\textsuperscript{59}

Although the functions of finders and brokers are not always clearly separable, if the middleman has authority\textsuperscript{60} to engage in negotiations, he is generally classified as a broker rather than as a finder.\textsuperscript{61} Brokers charge a commission, generally 6-7 percent of the sales price. Finders' fees\textsuperscript{62} are usually a lower percentage, generally 2-4 per-

\textsuperscript{58} See generally 8 C.F.R. § 214.2(e) (1976) (regarding time extensions for foreign traders and investors in the United States).

\textsuperscript{59} See Amerofina, Inc. v. U.S. Industries, Inc., 232 Pa. Super. 394, 335 A.2d 448 (1975), which discusses the differences between finders and brokers:

Such distinction as exists between these two terms is more a matter of trade usage than legal definition. In general, a finder is an independent actor whose role is that of a middleman who introduces the parties, supplies information to one or both about the other and is required to do little else, whereas a broker 'negotiates on behalf of one of the parties or performs or is required to perform some other act identified with the interests of one party and against the interests of the other.' . . . 'The finder is a person whose employment is limited to bringing the parties together so that they may negotiate their own contract . . . .'\textsuperscript{63}

\textsuperscript{59} at 400, 335 A.2d at 451 (citations omitted).

\textsuperscript{60} This authority can take the form of actual written authority or, alternatively, some other indicia of authority.


\textsuperscript{62} A finder's fee is a kind of commission as to which there is no percentage fixed by custom. In the absence of any agreement thereon, the percentage allowed to the finder depends on how much work is done by him, and what his position is in the deal vis-a-vis the persons with whom the banker [or other commercial operation] is negotiating it.
cent, although some charge as much as 15 percent when the source of their fee and the purchase money is undisclosed.63

Most finders' employment contracts are oral, in many cases consisting of no more than a phone call in response to a rumor. The nature of these agreements accounts for a good deal of litigation, primarily on the issue of whether the contract is subject to the Statute of Frauds.64 Recent decisions, particularly in New York, have denied recovery on oral finders' contracts in quantum meruit or on a theory of implied contract.65

Since finders' contracts are generally held to be within the Statute of Frauds, parties attempting to enforce an oral contract may assert as an alternative that the performance of the finders' service is part of a joint venture or partnership, and therefore a relationship provable by actual oral agreement.66 Courts have scrutinized such relationships closely, however, "to determine whether the facts warrant a conclusion that a joint venture or partnership was formed."67 Thus, parties may have difficulty in attempting to avoid the Statute of Frauds in this manner.

If a valid contract is found, the subsequent liability of the investor to the finder does not depend on the finder's participation in contract negotiations. Rather, the finder must merely bring the seller and purchaser together. This act is the necessary causal connection between the finder's activities and the ultimate contract agreement or

64. See, e.g., Minichiello v. Royal Bus. Funds Corp., 18 N.Y. 2d 521, 223 N.E.2d 793, 277 N.Y.S.2d 268 (1966), cert. denied, 389 U.S. 820 (1967), wherein plaintiff sought recovery as the "finder" of a purchaser for corporate stocks and debentures but no written contract was executed. The court interpreted the N.Y. GEN. OBLIG. LAW § 5-701(10) (McKinney 1964), to preclude recovery for "finders" on an oral contract or in quantum meruit.  
A 1964 amendment to this section, not applicable in Minichiello because of the time when the cause of action arose, explicitly places "finders" contracts "within the Statute." The report of the Law Review Commission, which recommended the amendment, notes that the intent was also to bar recovery in quantum meruit. See N.Y. Leg. Doc. No. 65(F) (1964). See also Featherman v. Kennedy, 122 Mont. 256, 200 P.2d 243 (1948) in which the court held that § 7519 of the Revised Codes of Montana precluded recovery under an oral agreement of compensation for finding and introducing the eventual purchaser of a ranch.  
65. See note 64 supra.  
67. Id. at 1259.
Because of the vagueness of this general rule, most finders' employment contracts should stipulate that either a contract or closing is required before the finder is entitled to recover.

An advantage to a principal in using a finder is that the principal may remain undisclosed. Nevertheless, when an undesirable purchaser's identity is not made known to the vendor, and the proposed use of the property is objectionable to him and would likely injure his remaining holdings in the neighborhood, the vendor may have a right to rescind the contract or the deed. Nondisclosure may annul the underlying transaction, even after closing. This secrecy may also lead to controversy when third parties, other than the vendor, are not informed of the vendee's identity until after closing.

The normal function of a finder is that of a property locator. In some cities, real estate brokers assist the finders in this function. The brokers generally know which telephone numbers to call to bring a finder to inspect the property. Finders contacted by brokers in this way work out of regional financial centers. Often such a finder is equipped with an exclusive agency and sometimes even the power of attorney to deal on behalf of the investor. The finder's function is normally and most easily aided or even assumed in this fashion by brokerage firms which conduct regional or statewide operations. Such firms tend to favor direct foreign investment in United States properties more than the local realty brokers do.

Finders are not the only group who perform the function of locating property. In addition to finders, investment counselors and real estate advisory departments of commercial lenders and merchant bankers may perform this function. Many investors, reportedly the Canadians and the British, tend to use a variety of intermediaries


71. The following discussion of finders is based on confidential interview memoranda, on file with author at the American University Law School.
who need not be located near the purchase;\textsuperscript{72} established business relationships are often more important than proximate location.

Finders are the most fragmented and disorganized group locating suitable investments for alien investors. Other individuals perform somewhat similar functions in a more structured fashion, often providing counseling exclusively for real estate investments. They usually work for private individuals, firms, and commercial banks.\textsuperscript{73} These consultants work for a contractually fixed retainer, with maximum and minimum amounts predetermined, subject to a renegotiation clause. This retainer is payable whether or not the investor finds suitable properties. Consultants are distinguishable from brokers inasmuch as they prepare prospectuses and circulate them using mailing lists provided by professional societies or maintained by the consultants themselves. The largest of these consultants work through computerized lists, the smallest by personal contacts and word of mouth. Consultants who deal exclusively in real estate investments generally have other capabilities helpful in analyzing potential investments, among which are skills in real estate appraisal, land use planning, and econometric modeling.

The larger consulting companies also generally perform the function of mortgage brokers. As such, their commissions are fixed as a percentage of the amount of the mortgage loan procured. These companies charge 1 percent, but will accept no brokerage contract involving less than a large minimum dollar amount.\textsuperscript{74}

Some of these firms have several other departments, such as a real estate advisory department, a real estate investment trust, and a realty management division. Their advisory services are provided on either a commission or retainer basis. Both types of advisors use local legal counsel who oversee the work of title attorneys and title-assuring services in the locale of the properties purchased. Whether served by real estate consultants or brokerage house subsidiaries, the clients most often sought are banks and pension funds with large amounts to invest.

The advisor's employment contract often includes a clause giving

\textsuperscript{72} See, e.g., Washington Post, Aug. 31, 1975, § B, at 2, col. 4, in which a transaction involved a Greenwich, Connecticut real estate broker and Boston, Massachusetts property.

\textsuperscript{73} This continuing discussion of consultants and brokerage subsidiaries is based on confidential interview memoranda, on file with author at the American University Law School. It should be noted, however, that commercial banks often choose to provide in-house expertise for themselves by establishing real estate advisory departments.

\textsuperscript{74} One such minimum dollar amount was five million dollars.
him "investment discretion," that is, the authority to execute the purchase, not just to recommend it to the client. Nevertheless, the misuse of this power to make a purchase, or even of the power to recommend a purchase, may give rise to fiduciary duties and liabilities.\textsuperscript{75}

In this time of increasingly large brokerage operations, American real estate brokers are, by and large, in favor of foreign investment in American natural resources and properties.\textsuperscript{76} Several organizations of brokers have been asked to go on record against foreign investment, but thus far the brokers have declined.\textsuperscript{77} This present noncommittal attitude toward foreign land purchases is unlikely to continue. There seems to be a developing trend toward foreign investment in American brokerage firms themselves, as evidenced by the fact that some foreign firms have moved either to open or to purchase brokerage companies in the United States.\textsuperscript{78} Foreign firms controlling domestic brokerage corporations are seeking to prove that brokerage can be as profitable as direct investment. Some states have for some time excluded aliens from the brokerage business by making citizenship a requirement for an individual's broker license.\textsuperscript{79} Thus far this has not


\textsuperscript{76} See Hawkinson, The Peaceful Foreign Invasion, SOC'Y IND. REALTORS REP., July-Aug., 1974, at 2, 8. Among the benefits to be gained from foreign investment are better markets, increased values, and greater prospects for world peace. \textit{Id.}

\textsuperscript{77} One such request was made after a foreign purchase of a large tract of ranch land in Wyoming. Ironically, some of the land was already in alien hands. The Montana Institute of Farm & Land Brokers asked the National Association of Realtors to condemn the trend represented by the sale. The president of the Association declined, favoring further discussion of the issue. \textit{Id.} at 10.

\textsuperscript{78} See Foreign Investment Inside USA Report 5, May 15, 1975.

\textsuperscript{79} See, e.g., FLA. STAT. ANN. § 475.17 (Supp. 1975) (requires citizenship or intent to become a citizen); GA. CODE ANN. § 84.1411 (Supp. 1974) (requires citizenship or filed intent to become a citizen); MICH. COMP. LAWS ANN. § 451.208 (1967) (requires citizenship); N.Y. REAL PROP. LAW § 440-a (McKinney 1968) (requires citizenship or declared intention to become a citizen followed by naturalization within seven years); PA. STAT. ANN. tit. 63, § 436(b)(2) (1968) (requires citizenship); TEX. REV. CIV. STAT. art. 6573(6)(b) (Supp. 1975) (requires citizenship).

The constitutionality of such laws, however, may be suspect. The Attorney General of California has stated that in the absence of a reasonable connection between the requirement of citizenship and an individual's fitness to practice a given profession or vocation, United States citizenship is not a valid requisite for professional licensure, and such a requirement would be violative of the equal protection clause of the fourteenth
stemmed the tide of foreign investment in domestic brokerage firms.

Despite the fact that some states have acted to discourage aliens from participation in the brokerage business, a large number of states are currently performing as intermediaries for foreign corporations who wish to acquire plant sites in the United States. The intermediary vehicle is often a state department of commerce or a state economic development agency. Fourteen states now have some twenty overseas agency offices to extol the advantages of sites for industry in their jurisdiction. State economic development agencies are represented in Washington by a trade association, the National Association of State Development Agencies (NASDA).

This organization coordinates the activity of providing information for foreign investors in such areas as economic incentives for investments, i.e., tax rebates, state-backed bond financing, free manpower training, and computer-assisted site location and master planning. Another function of this body is to encourage overseas promotions funded by the United States Commerce Department. Finally, NASDA also performs such functions as encouraging foreign corporate investment in plant amendment. 55 Op. Att'y Gen. 80 (1972). The California legislature subsequently repealed the statute requiring applicants for broker's licenses to be United States citizens. Cal. Bus. & Prof. Code § 10150.5 (West 1964) (repealed 1972). Minnesota has recently abolished a similar requirement. Minn. Stat. Ann. § 82.20(1)-(3) (Supp. 1975), formerly Minn. Stat. Ann. § 82.03(2) (1968).

Additionally, several decisions have struck down laws which have arbitrarily restricted the right of aliens to work in the United States. See, e.g., In re Griffiths, 413 U.S. 717 (1973) (statute excluding aliens from the practice of law violates equal protection clause of fourteenth amendment); Purdy & Fitzpatrick v. State, 71 Cal. 2d 566, 456 P.2d 645, 79 Cal. Rptr. 77 (1969) (statute prohibiting employment of aliens on public works contracts violates equal protection clause).

81. One writer has summarized the function of such units:

A state Economic Development Agency is responsible for promoting and generating the economic growth of its state, primarily through industrial development and expansion. In performing this mission, a state agency becomes involved in economic planning, development coordination with local communities, manpower development and training, financing assistance and other services . . . . The state offices also perform a liaison function with the various federal agencies involved in national economic development.

84. See note 83 supra.

sites and de-emphasizing foreign land purchases, as the latter produce few jobs and create local hostility. Some states have long provided various incentives to encourage industries to locate within their borders, but today the effort has taken on a new international scope.85

B. Financing the Purchase

1. Syndicates

Aside from the spectacular all-cash purchasers who grab the headlines, much financing is undertaken by syndication. A syndicate is a generic name for a group of investors. It may take the guise of a corporation, partnership, limited partnership, joint venture, trust mortgage lender, installment land sale purchaser, leaseholder, or output contractor.86

Foreign institutional investors87 are actively involved in these international transactions. One German syndicate reportedly representing 125 firms in 43 countries recently pledged $140 million to a new satellite town in the Boston metropolitan area.88 In this instance the collector of funds was a foreign syndicate. Nevertheless, American investment bankers have occupied the same role. For example, in late 1973, a Louisville, Kentucky financial and brokerage firm collected funds from Lebanese, Kuwaiti, and Persian Gulf investors which they then used to fund a package of loans.89

Financing by syndication is generally channeled through tax havens, the most popular of which are Bermudian, Bahamian, and

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85. Working in tandem, NASDA and the United States Department of Commerce implemented the "Invest in USA" program. The program has conducted seminars in Munich, Dusseldorf, Stockholm, Tokyo and Osaka, Japan, and has also sponsored numerous mini-conferences throughout the world. Over the years, state representation in these seminars has grown from seventeen in Munich (1971) to thirty-six in Japan (1973). Foreign response has also been enthusiastic. The 1973 seminar attracted nearly 500 Japanese industrialists in Tokyo and 375 in Osaka. H. Keough, State Efforts to Attract Foreign Direct Investment (undated, unpublished paper on file in American University Law Review office).

86. This list is not exhaustive; e.g., the corporation could also be domestic, out-of-state (for example, incorporated in Delaware or Nevada), or alien.

87. Many of these investors are European pension funds.

88. Foreign Investment Inside USA Report 4, June 1, 1974.

89. Wall St. J., Jan. 11, 1974, at 3, col. 4. These fundings were carefully-packaged investments for clients, collected on an individual basis. The president of the Louisville firm reported that negotiations for the funds took eight months. Initial investments in real estate were $50 million "backed by a $200 million line of credit." Foreign investors were promised a set rate of return, which suggests that the intermediaries might be compensated with any profits earned above the guaranteed rate. Id.
Netherlands Antilles corporations. For example, one attractive tax feature of the Netherlands Antilles corporation is that its shares may be transferred without tax consequences in the United States or Netherlands Antilles. In countries where, either by treaty or income tax statute, income from the shares of nonresident corporations is not taxed, this provides an international flow of tax-sheltered funds for investment.

2. Persuading foreign investors to use the American money market

The funds associated with foreign investment have been loosely described as "patient capital," "particularly suitable for investment in real estate," and "more concerned with inherent asset value than with earnings." But many foreign investors, particularly Middle Eastern investors, characteristically have as an objective a high but stable yield along with a modest appreciation in value. Such non-speculative investors, when negotiating with an American lending institution over possible sizeable deposits, usually request a guaranteed return (reportedly 12 to 14%) as a condition of the deposit. These deposits can present problems for smaller banks in that they are confronted with the prospect of doubling their assets overnight. A sizeable increase in a small bank's assets as a result of foreign investment

90. Interview with George Lefcoe, Professor of Law, University of Southern California, via telephone, Aug. 5, 1975. See also Forry, supra note 48, at 247-48. When a Netherlands Antilles corporation is utilized for these purposes, for instance, the corporation is formed to own United States real estate investments. The stock of the corporation is issued to foreign individual or corporate investors. Id.

91. This business structure provides relief from income, estate, and gift taxes in both the United States and the Netherlands Antilles. Forry, supra note 48, at 248.


There are also vehicles for such investments which are less individualized than the Netherlands Antilles corporation, for example, offshore realty investment trusts. The shares of these trusts may be traded on European stock exchanges with no tax consequences for nonresident investors in their home countries. See generally Kessler, Little Liechtenstein Still Draws Tourists—And a Lot of Money, Wall St. J., Oct. 3, 1975, at 1, col. 4.


can create an imbalance in the international flow of investment funds. This flow must be stabilized so that the investment represented by the deposits will last roughly as long as the domestic loans which the bank must make to pay for the use of the capital. More generally, the term of deposits must exceed that of loans if the stability of the banking system is to be maintained. Thus, the role of the banker is to turn short-term commitments (demand deposits which may be withdrawn at will) into long-term ones; in our investment system, mortgages perform that function admirably. Bank asset managers should realize that mortgages taken by foreign investors represent a long-term commitment to our economy and banking system. The banking community can therefore be expected to encourage foreign investment in United States land.

The American banker, however, will have difficulty in persuading the foreign investor to enter the American real estate money market. This is because the process of obtaining financing from American lenders is new and unfamiliar to foreigners. It is common knowledge in the financial community that American lenders demand more detailed credit information than do foreign banks and often require compensating balances for real estate loans. This unfamiliarity with American lending and the financial information required (which often amounts to a breach of privacy and confidentiality in foreign eyes) could lead foreign investors to (1) use only established banking relationships for their purchases in order to avoid wider disclosure; (2) pay cash; or (3) purchase the owner's equity in a property with assumable financing, i.e., assume the present mortgage. There is also a "herd instinct" at work: investors and their advisors tend to place money in areas where purchases by their countrymen have previously been made—hence, another explanation for the British preference for New York, or the Arab preference for the Southeast. This preference for a familiar geographic area, combined with an aversion to the unfamiliar American financing system, may prevent potential foreign investors from entering the money markets of an unfamiliar geographic area.

96. The vast potential investment flow of Middle Eastern "petrodollars" and their impact in Western, particularly American, financial circles, is discussed in Robardes, Spending the Oil Money, N.Y. Times, Aug. 4, 1974, § 4, at 4, col. 3.

97. Western bankers are concerned that most Arab investments in the United States and Europe are in short-term deposits and short-term government backed securities, which can be shifted at virtually any time. "They fear they can't absorb any more [short-term investment] without endangering their capital-deposit ratios, in other words their viability." Farnsworth, The Riches May Be too Much for the Oil Nations, N.Y. Times, Oct. 13, 1974, § 4, at 4, col. 2. See also Sulzberger, Of Time and a River of Oil, id., July 28, 1974, § 4, at 17, col. 6.
As more foreign development firms establish United States subsidiaries, however, the tendency to shun United States real estate capital markets will probably diminish. Moreover, as brokerage and financial firms are also acquired, familiarity with, and access to, United States mortgage lenders will certainly increase. Again, as with brokers, this may signal a change in American attitudes toward foreign investment. Today such attitudes are probably in a formative or transitional stage.

The input of foreign investors’ funds into the American mortgage banking system may create at least two important results. First, it could stimulate American real estate development. There is purportedly a great shortage of domestic capital for expansion of the American economy. This country’s chronic capital shortage for real estate development is well known. Regardless of whether this shortage is real or has been artificially induced by the unwillingness of lenders to provide capital at current interest rates, foreign investors could alleviate the problem by creating an influx of money into the United States. Indeed, increased foreign investment may lessen the need for the Federal Reserve Board to expand the money supply; foreign investment may thus provide a means for increasing the amount of available capital for real estate development without increasing inflationary pressures on our economy.

Second, commercial bankers, having relaxed the traditional separa-


99. If the alien investor’s aim is to protect his capital from uncertainties abroad, he may continue investing as much as possible. See note 44 & accompanying text supra. If the investment objectives set forth in the text accompanying note 49 supra are correct, it should follow that foreign entities are using “leverage” (borrowed funds) and that the cash component of the purchases is larger than usual in domestic transactions. The result is an attractive prospect for vendors who might otherwise have to wait out a long executory period while the purchaser obtains financing. One authority had defined leverage as follows:

[L]everage . . . involves the use of funds obtained at a fixed cost [e.g., borrowed funds] in the hope of increasing the return to [the owners] . . . . Favorable or positive leverage is said to occur when the firm earns more on the assets purchased with the funds [e.g., land] than the fixed cost of their use [e.g., the interest on the funds]. Unfavorable or negative leverage occurs when the firm does not earn as much as the funds cost.


100. See, e.g., Watson, Banking’s Capital Shortage: The Malaise and the Myth, Bus. Rev., Sept. 1975, at 3, 4; The Capital Crisis, Bus. Week, Sept. 22, 1975, at 42. It has been estimated that $4.5 trillion in new investment capital will be needed in the next ten years in order to maintain the United States’ real annual growth rate of 4 percent. Id.

tion of banking and investment advisory services\textsuperscript{102} by establishing and then advising real estate investment trusts (REIT's)\textsuperscript{103} could utilize foreign investors' funds to provide much needed capital for these REIT's.\textsuperscript{104} Thus the investment advisors of commercial banks have an interest in expanding the flow of foreign money into this country, both to increase the scope of their own activities, and to help alleviate the capital shortage presently affecting many REIT's.

Unfortunately, in the case of large banks, the banking process for making loans for real estate transactions to foreigners may be hampered by the organizational complexity of the banks themselves. Large bank loan officers are not necessarily concerned with researching and documenting the real estate transaction as thoroughly as would a conveyancer. Indeed, follow-up documentation is a "support service" and such communication between loan officers and supporting departments is often irregular.\textsuperscript{105} One result of this complexity is that investors tend to borrow funds for farmland purchases through regional banking institutions, where closer attention can be given to individual transactions.\textsuperscript{106} In the future, large banks, which are in most cases run by holding companies, can be expected to spin off subsidiaries or form partnerships with foreign banks to facilitate these transactions.\textsuperscript{107} If these spin-offs do not occur, however, organizational problems may persist in the future.


\textsuperscript{103} REIT is essentially an unincorporated trust or association, managed by one or more trustees, the beneficial ownership of which is evidenced by transferable shares or certificates. It must not hold property primarily for sale to customers in the ordinary course of its trade or business. I.R.C. § 856(a). REIT's are exempt from corporate income tax. For the original purpose behind the favorable tax treatment accorded REIT's, see I.R.C. §§ 856-58. One reason for the creation of REIT's was to give small investors an opportunity to invest in real estate through tax-exempt means. C. LEFEOE, LAND DEVELOPMENT LAW 573-75 (2d ed. 1974). See also Duval, Conflict of Interest Problems in the Management of REIT's, 3 \textit{REAL ESTATE L.J.} 23 (1974).


\textsuperscript{105} See Kessler, Citibank, Chase Manhattan on U.S. 'Problem List,' \textit{Wash. Post}, Jan. 11, 1976, § A, at 6, col. 1. A federal bank examiner noted of New York's Citibank:

The support areas, whose job it is to gather and keep current documentation and credit information, often do not report to the lending officers current information and trends, believing that the loan officer should inquire about such matters. \textit{Id.}

\textsuperscript{106} Confidential interview memorandum, on file with author at the American University Law School.

3. The role of attorneys

Domestic law firms counseling foreign purchasers of United States real property often perform wide-ranging advisory functions, but in the financing scheme they tend to become primarily involved as tax advisors. The expertise of these firms is apt to be in establishing real estate tax shelters for Americans and in creating real estate investment trusts. These law firms characteristically represent foreign governments, and maintain domestic political ties through their senior partners.

Foreign law firms reportedly manage and oversee the transactions of business entities which have incorporated in their countries. For example, several firms in the Netherlands Antilles handle the legal work of these corporations and oversee the management companies documenting their transactions.

C. Strategy of Choosing the Business Entity

A necessary concern for any foreign investor who is determining how he wants to take title to a piece of American real estate is the matter of the formation of a business entity for both syndicating the investment and financing the purchase. Of course, as in the formation of any business entity, the investor’s projected plans for this entity are of major importance in the kind of entity that is selected. And also, as is always important in the selection of an entity for conducting business, the tax consequences of the selection are a major consideration.

One of the key tax consequences for a foreign investor who has formed an entity for investment in American real estate will flow

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109. Interview with George Lefcoe, Professor of Law, University of Southern California, via telephone, Aug. 5, 1975. See also Lyons, Many Prominent Americans Represent the Interests of Foreigners, N.Y. Times, Jan. 20, 1976, § 1, at 10, col. 1.


111. Interview with George Lefcoe, Professor of Law, University of Southern California, via telephone, Aug. 5, 1975.


113. Other considerations in selecting the entity include the contractual and involuntary liabilities which may arise, the legal certainty of the form of the business association, and the relation between the investors and the syndicator. Id.
from an Internal Revenue determination as to whether the income from the property is "effectively connected" with the conduct of a trade or business in the United States.\textsuperscript{114} An alien corporation which holds property that is not "effectively connected" may be the most desirable form of business association because it may thereby qualify for favorable tax treatment.\textsuperscript{115} This is especially true if tax statutes and treaties allow the investors to receive tax-sheltered passive income. For example, while the Internal Revenue Code imposes a flat 30 percent tax on the rental income of alien corporations which are not engaged in the conduct of a trade or business in the United States\textsuperscript{116} (in lieu of the normal corporate or progressive individual rates on United States-source income), the rate is often lowered by treaty.\textsuperscript{117} Similarly, gains realized on the sale of property in this country by alien corporations not engaged in a trade or business in the United States are generally exempt from United States taxation.\textsuperscript{118} An alien corporation whose only activity in the United States is the passive holding of unimproved real property is in a position to argue persuasively that income received from United States sources is not "effectively connected income,"\textsuperscript{119} and is therefore eligible for favorable tax treatment.

Notwithstanding the above consideration, if a foreign investor is willing to set tax considerations aside, and wants to form an entity for the development of the property, then he should plan to provide for

\textsuperscript{114} See I.R.C. § 864(c), which defines "effectively connected income," and includes in the determination such factors (among others) as whether the income was derived from the assets of such business, whether the activities of such business were material in the realization of the income, and whether the income was realized from sources within the United States.

\textsuperscript{115} See I.R.C. § 882(a)(1), which provides "A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable . . . on its taxable income which is effectively connected with the conduct of a trade or business within the United States." Id. (emphasis added).

\textsuperscript{116} I.R.C. § 881(a).


\textsuperscript{118} I.R.C. § 881(a)(2).

\textsuperscript{119} See Forry, Planning Investments from Abroad in United States Real Estate, 9 INT'L LAW. 239, 242. Income is not likely to constitute effectively connected income "where net lease arrangements for the property provide that all maintenance and other activities and costs are to be undertaken by the tenants rather than the foreign owners." Id. See also Rev. Rul. 73-522, 1973-2 CUM. BULL. 226. The taxpayer, a nonresident alien individual, owned rental property in the United States that was subject to long-term net leases. He visited this country once during the taxable year to supervise lease renegotiations. The Commissioner ruled that such activity is not "beyond the scope of mere ownership of real property or the mere receipt of income from real property," and thus that no taxable event had occurred. Id. at 227.
this entity the services of a local agent or subsidiary. This agent or subsidiary would assure suppliers and jobbers that payment for work and materials furnished to the developer is the responsibility of an entity within the reach of the American legal system. The existence of such problems when there is no local agent of the investor, plus the advantages of having local representatives and supervisors in any development project, make the use of local American subsidiaries more likely in the future.

After a potential investor has chosen a business entity and is actively pursuing an investment, the parties to a real estate agreement may enter into a management contract\textsuperscript{120} either at the closing or shortly thereafter. Because such tasks as collecting rent, making repairs, and conducting negotiations with holders of superior liens\textsuperscript{121} often require on-the-spot supervision, many large realty brokerage firms are developing property management departments. Where the investment property is farmland, management firms are sometimes foreign owned and tend to be located in regional financial centers.

Regardless of the investment entity that is employed by foreigners, development and management of United States real estate may generate some other kinds of unique legal problems for the foreign investor. Nevertheless, these problems do not pertain to transnational conveyancing per se and are generally beyond the scope of this article.\textsuperscript{122}

\begin{footnotesize}
\begin{enumerate}
\item[120.] The following discussion is based on confidential interview memoranda on file with the author at the American University Law School. For a recent case wherein a court considered a common management contract, see Adams & Leonard, Realtors v. Wheeler, 493 P.2d 436 (Okla. Sup. Ct. 1972).
\item[121.] Holders of superior liens often include tax officials, contractors, and lenders.
\item[122.] For example, two areas in which the foreign investor may run afoul of American law are first, securities, and second, civil rights.

A securities problem arises where nonresident aliens invest in condominiums not for purposes of ownership, but for investment through rentals to unknowing Americans. The transfer of air-rights and membership in the home owners' association may qualify as a "security" requiring the vendor to register with state officials or the federal Securities and Exchange Commission. See generally SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (corporations offering persons in distant localities opportunity to contribute money and share in profits of citrus fruit enterprise through service contracts, land sale contracts and warranty deeds, were offering "investment contracts" within Securities Act requirement for registering such contracts); Greenwood, Syndication of Undeveloped Real Estate and Securities Law Implications, 9 Hous. L. Rev. 53 (1971).

A related securities problem involves contracts which provide for the mere sale or assignment of interests in real property, such as contracts for the purchase of dwelling units in cooperative housing projects. These contracts have been held not to constitute "investment contracts," and thus need not be registered as securities. Annot., 47 A.L.R.3d 1375, 1389-90 (1973). Where, however, a purchaser is not simply buying a unit in a building, but expects to share in the gross proceeds or the net profits of the indi-
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\end{footnotesize}
D. Taking Title

Before the closing the foreign investor or his attorney will want to assure himself that the vendor's title is marketable, that is, free from the clouds which may prevent later alienation or development.\textsuperscript{123} American methods for assuring marketability are materially different from those used in virtually all other countries.\textsuperscript{124} In the United States an attorney, abstractor, or title insurer passes on the marketability of the title by reviewing documents recorded in public land-related records.\textsuperscript{125} This is done each time a property changes hands.\textsuperscript{126} In most other countries a finding of marketability, once made, is not re-examined, but is merely updated to the time of the next transfer.\textsuperscript{127}

In the United States, the review of recorded documents results in an attorney's certification that the title is marketable. In urban areas, a policy of title insurance may supplement or replace this certificate.\textsuperscript{128} When the title-assuring process results in the issuance of a title insurance policy which names the foreign investor as the insured, some unique title problems may arise.\textsuperscript{129} Foreign purchasers, whether individuals, corporations, or governments, must disclose their nationality; failure to do so will become an "act of the insured" voiding the policy.\textsuperscript{130} This voidance will entitle the insurance company to return the premium and avoid liability for claims made under the policy as a result of alien divestiture.\textsuperscript{131} Therefore, a foreign investor should disclose his nationality willingly in order to avoid this result.

\textsuperscript{125} P. BASYE, CLEARING LAND TITLES 13-16 (2d ed. 1970).
\textsuperscript{126} Id.
\textsuperscript{127} Id.
\textsuperscript{128} Id. at 14.
\textsuperscript{129} See J. Pedowitz, Title Insurance—The Multiple-State Transaction, in PRACT. L. INST., REAL ESTATE FINANCING—CONTEMPORARY TECHNIQUES 105 (1973).
\textsuperscript{130} See Am. Land Title Ass'n, Single Form Policy of Title Insurance—1970 [hereinafter cited as ALTA Policy], Exclusions from Coverage, at 3, para. 3.
\textsuperscript{131} Alien divestiture refers to divestiture of the alien's title by the state.
There is another reason that it would be to a foreign investor's benefit to disclose his nationality. The situs state may have laws which place restrictions on title-holding by aliens. Disclosure of nationality to the title insurer will aid the title attorney or insurer in his search for a title-holding instrument which legitimately meets those restrictions imposed by the situs state. For example, if the restriction imposed by the state is a mere prohibition on alien landholding, the foreigner may be able to meet the strictures of the law. Establishment of corporate ownership may be sufficient in that shares of a corporation are personal property and thus outside the scope of legislation dealing with real property. In other instances, it may be advisable for the foreigner to become the beneficiary of a trust in order to hold personalty. Similarly, an interest in a limited partnership with an American bank as a general partner may be considered personalty. The methods for avoiding restrictions on alien landholding are various.

As respects the protection of the insurance company, the scarcity of cases and relevant legal materials regarding legitimate title-holding vehicles might necessitate the incorporation of special exceptions into the company's title insurance policy. For example, it may be advisable for the company to bar claims based on the legal consequences of the insured's nationality.

In still a different vein, it might be argued that there is no special title insurance problem which is posed for the insurance company by foreign ownership. Title insurance is a form of written assurance that, as of the policy date, title is good and marketable in the insured, whether he is a foreigner or not. Therefore, the argument goes, the insurance does not assure that no cloud will be placed on marketability after the date of policy, whether the cloud is imposed by some act of the state or by some other means. On the other hand an argument can be made that the insured would not bother with title insurance if he did not seek an assurance that he could use the property in the future. This latter proposition has found support in cases concerning policy holders who have claimed amounts based on the loss of future value, rather than on the purchase price of the

132. See notes 12-14 & accompanying text supra.
133. Interview with Hugh Brodkey, Vice President and Associate General Counsel, Chicago Title Insurance Co., via telephone, Jan. 15, 1976.
134. The ALTA policy provides that the company "insures as of Date of Policy . . . against . . . loss or damage . . . sustained or incurred by the insured by reason of: 1. title to the estate or interest . . . being vested otherwise than as stated . . . ." ALTA Policy, supra note 130, at 1.
property.\footnote{135} In this author's opinion, considering the ability of the alien to convey good title to third party Americans until the state divests the alien's title,\footnote{136} the better view is that the alien has a voidable but not a void title. Therefore the insurance company should not be liable in the event that the state exercises its right to void the title at some date after the date of the insurance policy.\footnote{137}

IV. MONITORING FOREIGN LAND OWNERSHIP

For the most part, land-related public records, traditionally kept on the county level in this country, do not provide an effective device for disclosing the extent of foreign investment in United States realty. These recording systems are ineffective for this purpose because they typically neither divulge the nationality of grantors and grantees nor provide a basis for statistical cataloguing of such interests.\footnote{138} The records are indexed only by parcel number or by the names of vendor and purchaser.\footnote{139} The intent of these recording laws is only to provide notice of ownership and encumbrances on real property, and not to provide notice of any foreign interest in that property. Thus it is clear that the present record-notice system\footnote{140} binds Americans to

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\footnote{135. \textit{See} Overholtzer v. Northern Counties Title Ins. Co., 116 Cal. App. 2d 113, 253 P.2d 116 (1953). The plaintiffs had brought action on a title policy which had failed to disclose the existence of an easement. In affirming judgment for the plaintiffs, the court declared that the insurer's liability should have been measured by diminution in value of the property caused by the defective title, as of the date of the discovery of the defect, rather than diminution in market value of the property measured at the time of purchase. \textit{Id.} at 130, 253 P.2d at 125.}

\footnote{136. The procedure by which the state divests the alien's title is termed "office found." It refers to a common law action whereby the state could divest an alien of his real property. Although aliens could, at common law, take lands by purchase, grant, or conveyance, they did not have the capacity to hold lands so taken against the state. The alien's title could always be divested at the pleasure of the sovereign by office found. \textit{3 Am. Jur. 2d Aliens and Citizens} \S\ 13 (1974).}

\footnote{137. It also should be noted that some insurance policies contain provisions placing upon the insured a duty to mitigate damages claimed. ALTA Policy, "Conditions and Stipulations," para. 3(e), at 13. Some also allow the insurer to clear a flawed title by purchasing the encumbrances on it, thus permitting the foreign interest to be sold if ownership is challenged by the state. \textit{Id.}, para. 5, at 14.}

\footnote{138. Furthermore, even if nationality could be determined from these records, due to the fact that each county's records are kept separate from those of other counties, no overall figures would be available. \textit{Cf.} P. Bayse, \textit{supra} note 125, at 8-13, which describes the most common county land recording systems.}

\footnote{139. \textit{Id.}}

\footnote{140. Recording provides constructive or record notice of the instrument and its contents regardless of whether the person alleging a subsequent interest actually saw the document or had another form of notice thereof. \textit{See} \textit{4 American Law of Property} \S\ 17.17, at 589 (A.J. Casner ed. 1952).}
honor foreign title-holdings while at the same time rendering them unable to ascertain the extent of the holdings.\textsuperscript{141} If secrecy is an objective of foreign investors, American land records serve this aim well.\textsuperscript{142}

It is apparent that the American recording laws are presently ill-adapted to provide information on foreign interests in land. Nonetheless, at this date, Iowa is the only state that has attempted to remedy this situation. The Iowa legislature recently enacted a statute providing for the disclosure of foreign interests in specified types of land, requiring the disclosure to be made to the secretary of state.\textsuperscript{143} The passage of a statute such as this one, requiring reporting separate from that required by the public recording laws, raises the issue whether such information might not be more accessible if it is integrated into the public records. In the future it would be advisable for state legislatures to consider this issue when drafting similar legislation.

\section*{CONCLUSION}

Foreign direct investment in American land has increased in recent years. Although there are some state law restrictions on this

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\item In another context, such a recording system may prevent foreigners who seek the notice giving protection of these laws from formulating their own investment policies in American jurisdictions.
\item Moreover, disclosure laws such as those administered by the SEC have not yielded significant amounts of information regarding the financial interests and backers of industrial purchases by foreigners. See, e.g., Ronson Corp. v. Liquifin, 370 F. Supp. 597 (D.N.J. 1974); Texasgulf, Inc. v. Canada Development Corp., 366 F. Supp. 374 (S.D. Tex. 1973); Annot., 6 A.L.R. Fed. 906 (1971). One has only to envision Arab money funnelled through a Dutch-controlled Canadian corporation whose shares become collateral for a loan by a Detroit bank disbursed through a Chicago attorney in order to understand the problems of disclosure laws in this area.
\item IOWA CODE ANN. § 567.9 (West Supp. 1976) provides in part:
Every nonresident alien, owning or leasing agricultural land, or engaged in farming outside the corporate limits of any city of this state, shall file with the secretary of state ... a report containing the following:
1. The nonresident alien's name, address, residence, and citizenship.
2. A declaration of the type of agricultural activity engaged in ...
3. The acreage and location of agricultural land owned outside corporate limits of any city ... .
4. The approximate number and kind of livestock or poultry owned ... and the approximate number of acres used for each agricultural crop ... .
5. The number of acres owned and operated by the nonresident alien, the number of acres leased by the nonresident alien, and the number of acres leased to the nonresident alien ... . The nonresident alien shall also disclose whether such nonresident alien is represented in Iowa by an agent or other representative and, if so represented, the name of the individual or firm acting in such capacity.
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investment, the states have not to any significant extent hampered the foreign investment effort. Since foreigners do have a relatively easy access to the American land market, and also because transnational conveyancing is a more complicated process than domestic conveyancing, foreign interest in American land creates important opportunities for a number of Americans. Finders, brokers, and other financial advisors must assist the investor. Bankers have a keen opportunity to persuade foreigners to draw upon the American mortgage money market. Attorneys can assist the investor by advice about the proper business entity for an investment, especially in regard to the tax consequences of choosing a particular entity. The attorney should also assist in the title-assuring process by advising his foreign client about the special title insurance problems involved in insuring a foreigner's purchase.

In addition to these implications of foreign investment for certain key American personnel, increased foreign investment has important consequences for America as a whole. Various regions of the country seeking development can anticipate increasing competition for the foreigner's capital. Foreign capital could provide a stimulus to American real estate development in general without fueling the fires of inflation. Nevertheless, despite these attractions of foreign investment, increased investment will necessarily mean larger and larger portions of America owned by foreigners. If this is to be so, Americans have a right to know the nature and extent of foreign real property holdings in the United States. American recording laws are presently ill-adapted to provide this information. Special legislation is needed if future foreign purchases are to be effectively monitored.

In broader perspective, with the international legal system moving toward two somewhat antithetical goals—transnational investment codes\textsuperscript{144} regulating the flow of investments and the sovereignty of a nation-state over its natural resources\textsuperscript{145}—Americans would be wise


to generate information enabling a decision as to what control, if any, over what types of properties is necessary for the future. Unfortunately, American conveyancing institutions lack the capacity to produce even the necessary facts on alien property interests to provide a basis for such an informed decision in the United States today.