COVER **STORY**

AMERICA STILL THE FIRST CHOICE FOR FOREIGN INVESTORS

WILL CHINESE REMAIN THE TOP INVESTORS IN U.S. COMMERCIAL REAL ESTATE?

By **SANJAY MUNDRA, CEO - SVN HOTELS**

Over the past five years, China exponentially increased investments in the U.S. commercial real estate market, and signs point to continued growth for the coming year. Starting in October 2014, China's Anbang Insurance Group captured the attention of U.S. hoteliers with the purchase of the Waldorf Astoria in New York for $1.95 billion, surpassing the record for money spent on an American hotel. Now, according to Forbes, the Chinese are the number one group of foreign investors in U.S. commercial real estate. While the increase in investments was slow to start, China enjoyed a number of key catalysts over the past five years which have not only catapulted them to the top, but will ensure they maintain the top slot for foreign investors in U.S. commercial real estate.

The initial policy change

One of the top events influencing increased Chinese foreign investment activity was a policy change in 2014. Prior to 2012, Chinese insurance companies were limited to exclusive domestic real estate investments. But in 2014, the Chinese Insurance Regulatory Commission (CIRC) amended the policy to enact a new rule allowing Chinese insurance companies the freedom to invest up to 30 percent of their assets in real estate and up to 15 percent of their total assets in foreign markets. This move by CIRC was likely motivated by the falling value of the yuan and hopes of bolstering the economy. Because the value of the dollar outranked the yuan, investing stateside was an attractive option for improving the Chinese economy.

Leading Chinese insurance groups moved fast to capitalize on this new arrangement. In 2014, Chinese outward FDI flows totaled $116 billion, and approximately $18.1 billion flowed into the U.S. for assorted investments. By 2015, Chinese outward FDI flows totaled $118 billion, and Chinese foreign direct investment flows into the U.S. increased to $22.3 billion, with the key increase in the hotel industry. This policy change, and the regulations that follow, had an immediate impact on Chinese investment activities in the States, but it wasn't the policy alone that brought China to the U.S. commercial real estate market.

Investments in America

According to Goodwin Law, America is attractive to investors because of

1) the return potential

2) variety of investment opportunities

3) economic, legal, and general market stability, and the size and maturity of the market.

In January 2017, the Association of Foreign Investors in Real Estate (AFIRE) conducted a survey that confirmed 95 percent of respondents planned to increase or maintain their level of U.S. investment in the real estate market this year. With a sound reputation, not easily swayed by a new administration in 2017, America is still the top choice for foreign investors in 2017. But due to the steady devaluation of the yuan, Chinese investors are certainly more motivated to increase investments.

The investment we are seeing now from China is much different than the Japanese investment in the 1980s. The Chinese are looking at American investments as a whole—there are no geographical limitations. The Anbang Group's acquisition of more than $9 billion of property from Blackstone in less than three years, including the $392 million 2017 purchase of the 557-room DoubleTree by Hilton Amsterdam Centraal Station, is an example of the very aggressive global real estate investments being made by Chinese companies.

> "APPROXIMATELY TWO MILLION CHINESE CITIZENS VISIT THE U.S. EACH YEAR, WITH A RISING PROJECTION FOR THE NEXT DECADE."

Considering how foreign investments are more beneficial to private firms, some speculate on how U.S. real estate deals could improve the value of the yuan. The short answer is tourism. Throughout 2016, Chinese investments in the American real estate market revealed a trend towards major U.S. cities on the east and west coasts. According to Cushman Wakefield data, the top five markets for Chinese investments in 2016 were New York City (46 percent), San Francisco Bay Area (15 percent), Los Angeles (7 percent), Chicago (5 percent) and Seattle (2 percent). What each city has in common is the fact that they are all major Chinese tourist destinations. Approximately two million Chinese citizens visit the U.S. each year, with a rising projection for the next decade. By investing in these major tourism-oriented U.S. hospitality markets, Chinese insurance groups can reclaim some of the capital outflow from native tourists. As mentioned above, this is one of the many ways that the U.S. has provided a strong return on investment. Based on this premise, it should come as no surprise that Chinese insurance companies drastically increased spending as a result.

Capital gains

Chinese insurance groups were still the third largest foreign investor in U.S. commercial real estate in 2015, behind Canada and Singapore.

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In 2015, Starwood Capital Group sold the flagship Baccarat Hotel New York to an affiliate of Sunshine Insurance Group. Pictured here, The Bar, featuring opulent red Baccarat chandeliers, where all libations are poured into pieces of Baccarat crystal.
Image courtesy: © SH Group Operations, L.L.C.

In 2016, 62 percent of Chinese investments in U.S. hotel purchases totaled over $1 billion per deal. Aforementioned Anbang Insurance Group closed on most of its $6.5 billion acquisition of Strategic Hotels & Resorts in September 2016. Additionally, China Life Insurance made headlines in October 2016 when they bought a portfolio of hotels from Starwood Capital Group for $2 billion.

At the end of 2016, China claimed a number of key footholds in the U.S. hotel market, and inbound investment deals reached a record high of $19.2 billion in the States (Cushman Wakefield). Out of this total, Chinese investors contributed $8.6 billion into U.S. hotels purchases, up from $2.8 billion in 2015 (Forbes).

Then, in March 2017, they spent enough to secure the number one position for leading foreign investors.

This was a surprise to many, due to new sanctions placed on Chinese investors in 2017 which limited foreign investment deals.

Complications with the yuan

Despite initial hopes of increasing cash flow through investment deals, the value of the yuan was at an all-time low in over two decades at the end of 2016. The drastic increase of outflow to American real estate from 2015 to 2016 wasn't translating into equal returns in the domestic Chinese marketplace. In an effort to slow capital outflows, Chinese regulators responded swiftly with a series of restrictions concerning outbound investments.

Essentially, the People's Bank of China must

1) refuse to process cross-border yuan payments until inflows and outflows are balanced

2) strictly examine funds overseas

3) enforce further restrictions for purchases of offshore assets

Forbes explained the new limitations by stating, "[They are] designed to stem capital outflows and preserve China's massive dollar reserves, which prop up the yuan, the capital controls are slowing deal flow and making it more

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difficult for even state-owned enterprises to move money out of China."

These new restrictions have already made waves in the real estate market. The Financial Times reported on Beijing's capital controls in January, which caused a shocking 84 percent plunge in foreign property investment by Chinese companies. These additional restrictions have made cross-country deals more time-consuming and less certain.

For these reasons, the majority of hoteliers are not expecting increased activity from Chinese investors anytime soon. But a few lingering factors still grant favor to China in the American commercial real estate marketplace.

THE CHINESE ANBANG INSURANCE GROUP BOUGHT WALDORF ASTORIA HOTEL FOR $1.95 BILLION IN 2014. IT IS CURRENTLY CLOSED WHILE UNDERGOING A COMPLETE RENOVATION AND RESTORATION.

Image Credit: © 2017 Waldorf Astoria

More assets to share/pursue

Because China rose so rapidly to the top of the heap, it is unlikely that another country will surpass their spending in this fiscal year. Forbes reported that the second largest group of foreign investors in U.S. real estate during 2016 was Canada, trailing behind China's $19.2 billion of investment deals at $13.1 billion.

The 2017 Chinese capital controls may seem unsurpassable, but signs of relaxed outflow of funds are already appearing. Recently in April, the Central bank relaxed the policy concerning cross-border yuan payments so that they can be processed without outflows matching inflows. A relaxation in regulations, coming so quickly after the initial move proves promising for future foreign investments.

In 2016, HNA Tourism Group entered into an agreement with Carlson Hospitality Group for the acquisition of Carlson Hotels, Inc. Pictured here, the Radisson RED OUIBAR in Minneapolis. Radisson RED is a new hotel philosophy with a flexible service concept.
Image courtesy: © 2017 Carlson Rezidor Hotel Group

"WITH THE REMOVAL OF FOREIGN TRADE REGULATIONS, THERE IS NOTHING STOPPING CHINESE INVESTORS FROM INCREASING SPENDING IN 2017."

The current wave of Chinese investments in the U.S. market may have experienced an initial lull at the beginning of the year, but now spending can continue. The potential for further investments from Chinese insurance agencies is too large to ignore. Only one percent of Chinese insurer assets are invested overseas, and of that only a fraction is invested in U.S. commercial real estate. China's insurance industry is valued at approximately $1.83 trillion, according to CIRC figures. With the removal of foreign trade regulations, there is nothing stopping Chinese investors from increasing spending in 2017.

In my opinion, Chinese investments will not slow down anytime soon. The large transactions in 2016 like the Carlson Rezidor and Waldorf Astoria deals, and the more recent HNA stake in Hilton for $6.5 billion, are proof that the Chinese want to invest for the long-term in America hotel properties. hT

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