SUSTAINABLE BUSINESS STRATEGIES WITH POLICY-DRIVEN ECONOMIES

by

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Submitted to the Program in Real Estate Development in Conjunction with the Center for Real Estate in Partial Fulfillment of the Requirements for the Degree of Master of Science in Real Estate Development

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ABSTRACT

Since 2010, China has put forward ample efforts to liberalize its currency and financial systems to transition into an economy with sustainable growth. However, the severe capital flight in these past two years prompted the government to place capital control regulations on both retail (individual) and institutional investors engaged in cross-border investments. These regulations include temporary halts of various programs such as the Qualified Domestic Institutional Investor Scheme and the Qualified Domestic Limited Partner initially devised to facilitate a smooth capital flow in the Shanghai Free Trade Zone, while promoting new initiatives such as the Stock Connect and One Belt One Road. The action of the government has since stabilized a continuously devaluated Renminbi and increased the alarmingly low level of foreign reserve. On the negative note, however, the regulations also dramatically suppressed the volume of cross-border transactions and subsequently caused changes in Chinese investors' profile, partnership structure and preference for overseas markets.

The fast change of the investment dynamics prompts questions including if there is still strong demand for foreign assets by Asian investors, what are the channels to continue to engage with China-based investors and their capital, how to build a sustainable business strategy with a policy-driven economy, and what the potential future risks would be. To answer these questions, it is important to distinguish between channels that are temporally closed but in the long term will continue to play a significant role in liberalizing the Renminbi and channels that are still viable even under the capital control regulations. Hong Kong plays a strategic role in this discussion.

This thesis is based on rigorous research combined with an in-depth analysis of the strategies of local market players who have established business relationships with Chinese investors and formed insights into future developments based on the current investment dynamics. The thesis attempts to provide an idea of the gradually changing landscape of global investments and propose more sustainable business strategies with investors domiciled in policy-driven economies such as China's.

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1. INTRODUCTION

In March 2017, Anbang Insurance, the largest insurer of China well-known for its record $1.95 billion acquisition of New York's landmark Waldorf Astoria hotel from Hilton Worldwide Holdings, broke off the talk on a potential acquisition of 666 Fifth Avenue office building in Manhattan (Yu & Delaney, 2017). This is only one of the recently called-off deals between Chinese investors[1] and their overseas partners. The cooling-down shopping spree of foreign assets by Chinese investors has much to do with the latest capital control regulations, which have already caused changes of investors' profile and their strategies. Accordingly, the local partners having been in business with investors from the second largest but highly policy-driven economy will need to be aware of available channels to sustain the collaboration on global investment opportunities.

This thesis will start by identifying the persistent demand for overseas assets by Asian investors to diversify their investment portfolios. This is followed by a brief review of recent programs devised to facilitate the internationalization of Renminbi and a smoother capital flow. The thesis will then explain the causes and timing for this round of capital control, and available channels to continue to utilize Chinese capital. The following chapters will discuss the strategic role of Hong Kong as a special platform for cross-border investments. Last but not least, corresponding to the changes of investors' strategies from policy-driven economies such as China's, how overseas partners could keep up their expectations on project scale, partnership structure and exit strategies. London and Boston are researched as case studies.

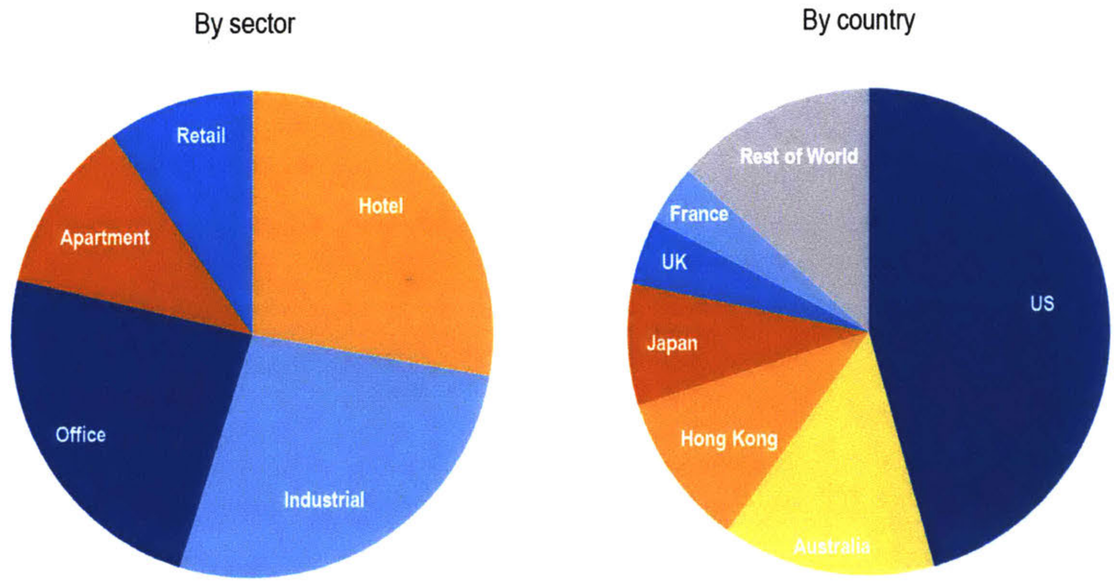
[1] In this thesis, Chinese investors include China-based and Hong Kong-based investors.

2. ASIAN INVESTORS LOOKING FOR DIVERSIFICATION

The growing interest in Western markets by Asian investors is not a recent phenomenon. According to Preqin Investor Outlook: Alternative Assets H2 2017 (Preqin, 2017), Asia-based investors have established significant presence in almost all economic regions, especially in the real estate sector. Over 40 per cent specifically target funds with a focus on North American and European markets with an aim towards diversifying their investments.

A recent research report by Hodes Weill & Associates and Cornell Baker Program in Real Estate (Dustin C., Weill, Hodes, Park, & Lisa, 2017) concluded that target allocation to real estate in institutional portfolios increased to 10.1% in 2017 for the first time in the recent years. According to the Global Family Office Report 2017 by UBS and Campen, the family offices in Mainland China and Hong Kong have a remarkably high allocation of asset favoring real estate compared to other regions based on tracking 262 family offices with $921 million assets under management. The report also shows that the young generation of the Asian families receive more grooming, training and prefer long-term returns. Statistics suggests that compared to 16.2 per cent globally, 20.3 per cent Asia Pacific, 26 per cent of the Hong Kong portfolios were invested in real assets in 2016 (He, 2017). Currently, there are 1,570 overseas properties owned by Chinese investors and the capital flight totaled $88.4 billion between 2010 and 2017 (Blazkova, 2017). The existing composition of asset types and geographic locations are as follows:

Figure 1. *Global Overseas Commercial Real Estate Holdings of Chinese Investors*



Source: Real Capital Analytics (based on property count, excluding development sites)

Despite the strong appetite for overseas real assets by Asia-based investors, China-based investors as a major composition of the investors group are contributing to a rapid decline of investment activities recently. The total overseas acquisitions amount decreased 15 per cent year-on-year in H1 2017[2] due to the recent regulations and scrutiny by Chinese authorities on cross-border investments. The dramatic slowing down of property acquisitions is accompanied by news involving largest China-based investors scrapping plans on deals under negotiation. For example, Dalian Wanda Group recently aborted the purchase of Nine Elms Square in London and the buyout of Dick Clark Productions (the operator of the Golden Globe movie awards). The breakdown of these deals is due to decreased financing and stricter scrutiny on acquisition targets in the wake of the capital control by China starting November 2016.

In contrast to the dismayed China-based investors, Hong Kong-based investors are continuing their cross-border expansion. In fact, the Nine Elms Square will be taken over by a

[2] Based on Real Capital Analytics (RCA), the total acquisitions amount was $10.1 billion for Chinese investors in 2016.

consortium of Guangzhou R&F Properties[3] and CC Land with a price tag of £470 million ($606 million) (Kwok & Jim, 2017). The former does not need to seek for authorities' approval because its capital is already parked offshore. The latter is a Hong Kong-based developer who acquired the "Cheesegrater" 122 Leadenhall Street in London from British Land and Oxford Properties at £1.15 ($1.5) billion in March 2017. Another newsworthy acquisition was the £1.28 ($1.7) billion purchase of the "Walki-talki" 20 Fenchurch Street by Hong Kong-based Lee Kum Kee Group from Land Securities and Canary Wharf Group in July 2017.

The continued growing interest in Western markets by China-based investors against the tough stance to clampdown capital flight has resulted in the change of investors' profile and strategies in participation of deal making. This also prompts the parties involved in cross-border investments to adopt sustainable business strategies in order to remain competitive with one party or more is strongly influenced by government policies such as capital control.

In the following chapters, a brief introduction of the multiple ongoing efforts aimed at China's greater integration with the global market, the reasons for the capital control and potential channels to continue to engage with Chinese investors will be discussed.

[3] R&F agreed to take over 77 hotels from Wanda for ¥19.9 ($3.0) billion in August 2017 and the developer acquired Vauxhall Square development in central London with £1,557.8 ($2,054.7) million in April 2017.

3. EFFORTS TO AN INTERNATIONAL ECONOMY

The economy of China experienced fast growth in the past decades. It is ranked the second largest by nominal Gross Domestic Product (GDP), and the world's largest by purchasing power parity by organizations such as International Monetary Fund (IMF, 2014). The growth is astonishing with a nominal GDP of $9.2 trillion today compared to $214 billion in 1978 – when the economy first opened up. China's economy is policy-driven, which on the positive side led the country through tough moments such as the 2008 financial crisis with government sponsored $585 billion stimulus package but also raised concerns on a compromised market mechanism.

Since 2010, the economy started to undergo a series of regulatory reforms under the administration of President Xi Jinping and Premier Li Keqiang to transition to a more balanced economy even if it led to a slowdown in GDP growth to only 6.7% in 2016 (FocusEconomics, 2017). There are multiple efforts by the Chinese authorities to further open up the economy and better integrate with the global market in order to maintain a healthy economic growth. These measures include: the launch of a pilot scheme for Renminbi trade settlement, the setup of Shanghai Free Trade Zone, the establishment of the Stock Connect, and the promotion of the most recent One Belt One Road Initiative.

i. Renminbi Internationalization

The People's Bank of China (PBOC) manages a floating exchange rate for Renminbi based on domestic and international economic developments. Between 1995 and 2005, a fixed exchange rate of around 8.28 CNY per USD was maintained, which was later switched to a managed float rate to control the currency appreciation since 2005. However, between 2008 and 2010, the Renminbi was re-pegged to the US Dollars at 6.82 CNY per USD, and has since been revalued by

PBOC to maintain close to the market value. Renminbi is freely convertible under the current account[4] but strictly regulated in the capital account[5]. To promote Renminbi to be a global reserve currency and attract foreign investments, the Chinese authorities expressed determination to liberalize the currency. For example, the National Economic and Social Development aspired to internationalize the Renminbi in an orderly fashion and also incorporated this goal in the Thirteenth Five-year Plan. A pilot scheme for Renminbi settlement was launched in 2009 by the Chinese authorities, and since then the use of Renminbi in cross-border transactions has increased dramatically. Hong Kong as a major international financial center and the gateway connecting China to the global market, was positioned as the Renminbi business center, and the international hub for Renminbi trade settlement, financing and asset management.

ii. Schemes Designed for Institutional Investors

To further relax the capital flow, nonresident portfolio investors can invest in China stocks A-shares through the Qualified Foreign Institutional Investor Scheme (QFII) since 2002, and through the Renminbi Qualified Foreign Institutional Investor Scheme (RQFII) since 2011.

The capital flow is allowed both ways. Domestic investors can access foreign markets and invest in bond and securities through fund management institutions, insurance companies, securities companies and other assets management institutions approved by the China Securities Regulatory Commission (CSRC) under the Qualified Domestic Institutional Investor Scheme (QDII), a similar transitional arrangement to QFII or RQFII. The Chinese authorities initially granted 15 banks and funds a total quota of $14.2 billion to invest overseas in May 2007. There are restrictions in place which include the minimum commitment by each client is ¥300,000

[4] Current account records items of a flow nature such as exports and imports of goods and services.
[5] Capital account records changes in stocks such as purchase and sale of foreign assets.

($50,000); the net value invested in stocks must not exceed 50% of total amount with the net value of a single stock capped at 5%; and the stocks invested must be listed on or approved by a regime that has signed memorandums of understanding with the CSRC. Despite that the capital flow is not completely free, this is a major step forward to a more open economy.

iii. Shanghai Free Trade Zone Setup

The Shanghai Free Trade Zone is a testing ground established to reform trade, investment, finance and governmental administration. The concept was approved by the State Council of China on 17 August 2013. The distinction of this event is the adoption of the negative-list approach which is less restrictive for innovation and reform especially for the financial sector. The financial reform measures are aimed to improve various aspects such as interest rate liberalization. Approved Chinese banks can engage in offshore businesses and establish joint venture banks between domestic private capital and foreign capital, which prepares the zone to evolve into an offshore financial sector onshore (J.P.Morgan, 2013). Another pilot program is the Qualified Domestic Limited Partner (QDLP) which allows foreign fund managers (including some hedge funds) to raise Renminbi through limited partnership with qualified domestic investors to invest offshore funds denominated in foreign currencies.

Overall, the goal is to establish an institutional system that is in keeping with the international rules of investment and trade with the highest degree of openness, currency conversion freedom, and a sound legal environment.

iv. Stock Connect Establishment

The Stock Connect between the Shanghai and Hong Kong exchanges was launched in November 2014 and was extended in late 2016 to encompass the Shenzhen stock market. The establishment of this program is to continue the gradual internationalization of Renminbi. It also creates one single China stock market with $10.6 trillion market capitalization as of December 2016, which only trails the New York Stock Exchange (Goldman Sachs, 2016).

The equivalent of Hong Kong Exchange (SEHK) is the Shanghai Stock Exchange (SSE) in Shanghai and the Shenzhen Stock Exchange (SZSE) in Shenzhen. The establishment of the cross-border investment channel allows mutual stock market access between SEHK, SSE and SZSE. China-based investors can invest directly in designated securities listed on SEHK while Hong Kong and international investors can invest in designated securities listed on SSE and SZSE.

The highlights of the program include quotas of ¥13 ($2.0) billion in northbound trade (HK to China) and ¥10.5 ($1.6) billion in southbound trade (China to HK). The quotas are the same for Shanghai – Hong Kong and Shenzhen – Hong Kong. There is no aggregate quota mechanism in place. In addition, upon the opening of Shenzhen – Hong Kong Stock Connect, the potential inclusion of ETFs was announced, too.

Since the thesis topic is on capital outflow, only southbound trading will be discussed. According to Hong Kong Exchanges and Clearing Limited (HKEx), trading under Stock Connect is open to all Chinese retail investors who possess no less than ¥500,000 ($76,300) but the trading will be limited to secondary market. Eligible equities are limited to those listed on the main board, including all constituent stocks of Hang Seng Composite LargeCap Index (HSLI), Hang Seng Composite MidCap Index (HSMI) for Shanghai – Hong Kong Connect, and constituent stocks of the Hang Seng Composite SmallCap Index (HSSI) with a market capitalization of no less than HK$5 ($0.6) billion for Shenzhen – Hong Kong Connect. Dual-listed stocks for both A-shares[6]

[6] A-shares: shares of companies based in Mainland China listed on Shanghai or Shenzhen stock exchanges and only available to Mainland Chinese investors and Qualified Foreign Institutional Investors. Stocks traded in Renminbi.

and H-shares[7] are also eligible subject to exceptions. At this initial stage, stocks listed as Real Estate Investment Trusts (REITs), like other structured products and bonds are not eligible for this program. However, with ETFs to be incorporated in the near future, the Stock Connect program has the potential to steadily evolve into a more complex and comprehensive establishment.

The Stock Connect is not mutually exclusive to QDII and RQDII therefore provides an alternative for competitive pricing since market force will eventually close the initial gap of prices of investment on the same product through different channels.

When trading securities quoted in Hong Kong Dollars for SEHK listed securities, Chinese investors settle trades with China Securities Depository and Clearing Corporation Limited (ChinaClear) in Renminbi who converts it into Hong Kong Dollars for settlement with Hong Kong Securities Clearing Company Limited (HKSCC). HKSCC and ChinaClear are "responsible for the clearing, settlement and the provision of depository, nominee and other related services of the trades executed by their respective market participants and/or investors" (HKEx, 2017). The exchange rate between Renminbi and Hong Kong Dollars fluctuates since the former is still not fully convertible while the latter is pegged to the US Dollars. The design of the Stock Connect as a closed circle ensures that it is sealed from the rest of market. Therefore, when a position acquired through this mechanism is sold, the profit is converted back to its original currency so that it cannot be deployed in the other market for other purposes.

The Stock Connect that links the three stock exchanges is considered to be a milestone in easing the tight restrictions on the flow of capital in and out of China and further deepens the

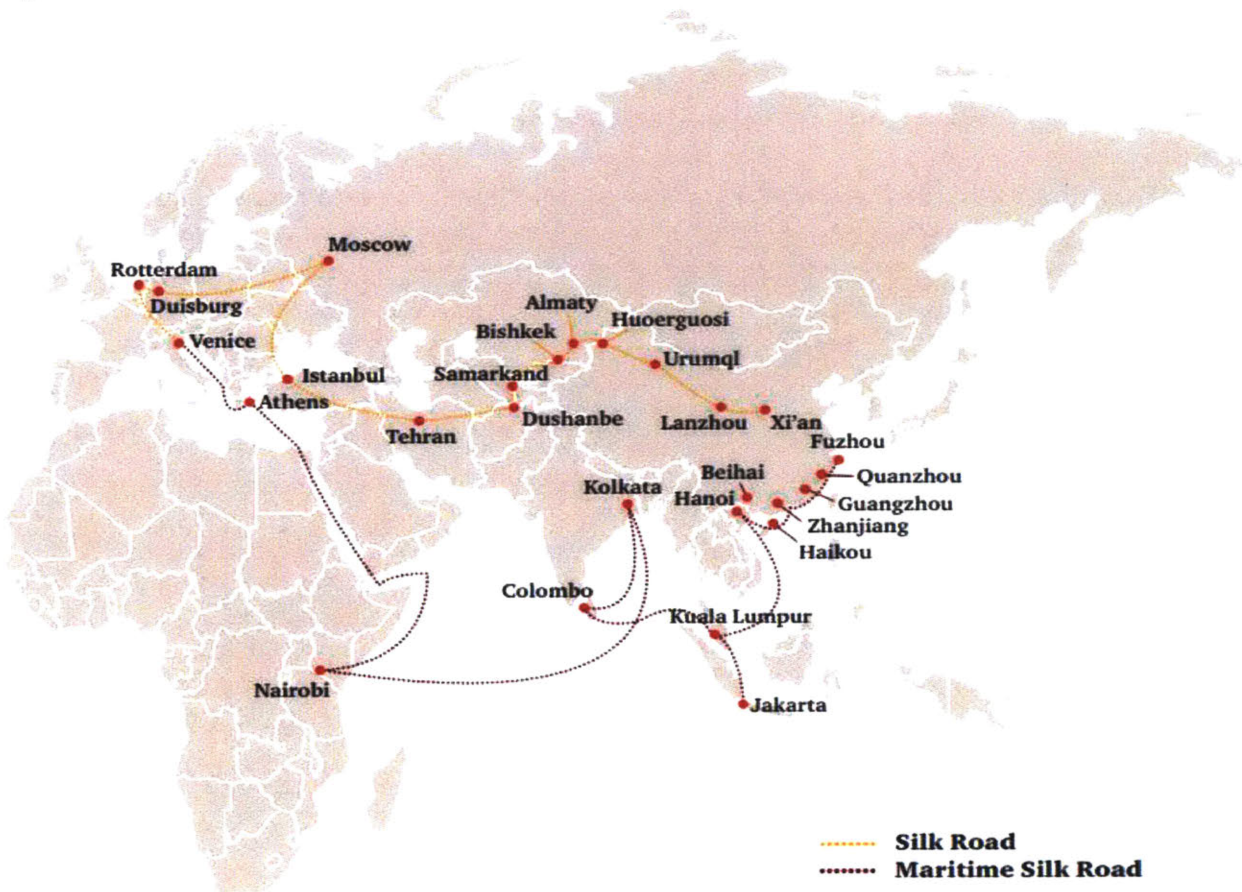
[7] H-shares: shares of companies based in Mainland China listed on Hong Kong Stock Exchange and available to all investors. Stocks traded in Hong Kong Dollars.

liberalization of the China market. Hong Kong again proves itself to be a very crucial gateway for Chinese investors to invest in global markets.

v. One Belt One Road Initiative

In 2013, the One Belt One Road Initiative (OBOR) was proposed to establish a network of railways, roads, pipelines, and utility grids that would encourage infrastructure developments and provide better connectivity between Asian, European and African continents. The two routes authorized by the State Council in 2015 are the Silk Road Economic Belt and the 21st Century Maritime Silk Road. The program is an estimated $1 trillion infrastructure spending that spans across more than 60 countries with a combined GDP of $21 trillion.

Figure 2. *Silk Road and Maritime Silk Road*



Source: Xinhua

Achievements so far include signed bilateral cooperation agreements related to the project between China and Hungary, Mongolia and Russia. Projects being undertaken includes a train connection between eastern China and Iran potentially to be expanded to Europe. More than 200 companies have signed cooperation agreements for development projects (Tian, 2016).

vi. Conclusions

It is this massive effort and long-term "going global" strategy that gradually moves the China economy towards a more liberal and globally integrated direction. The regulatory measures have "freed up" a wide range of industries including finance and real estate, which also gave investors more confidence in cross-border investments in various sectors.

4. A TWIST IN THE STORY – CAPITAL CONTROL

The efforts to liberalize the economy and currency in the past few years were taken as encouragement by Chinese companies to actively engage in cross-border transactions, especially acquisitions of foreign assets. This trend started in 2010 and stretched until late 2016 when a series of policies were put forward to suppress the capital outflow. More than $1.2 trillion has left China since the Renminbi devaluation in August 2015 (Bloomberg, 2017). The capital flight has led China to take actions such as selling dollars to avoid further devaluation. It resulted in a worryingly low level of the value of foreign exchange reserves to below $3 trillion in January 2017 for the first time since February 2011. Starting from November 2016, unofficial instructions were dropping – banks extending or halting the processing of cross-border Renminbi payments, directing some state-owned enterprises (SOEs) to sell off foreign currencies, mandatory disclosure of transactions involving foreign exchange with capital amount higher than $5 million – to name a few. In addition, the State Council started to require a sign-off by the government authorities on foreign investments over $10 billion or $1 billion if it's outside of the acquirer's "core" business. The checks and controls by the Chinese authorities have been effective in delaying cross-border deal flows. Companies such as BlackRock and Aberdeen Asset Management that have received the QDLP licenses are now faced with uncertain waiting period to receive quotas for cross-border investments. Similarly, the Qualified Domestic Institutional Investor 2 Scheme (QDII2), an updated program for overseas equities investment is delayed by the State Administration of Foreign Exchange (SAFE) as well. In August 2017, the State Council has officially approved guidelines by China's Central Bank, State Planning Agency and Finance and Commerce Ministries on regulations targeting "irrational" outbound investments in the property, entertainment and sports sectors to formally endorse the restrictions starting November 2016. This move reinforced the regulations by the SAFE and the China Banking Regulatory Commission (CBRC) on increasing scrutiny of individual foreign exchange purchases and anti-money laundry activities, as well as cracking down on capital flight and reducing financial risk by lowering corporate indebtedness. Investors will have weaker control on the channels through which how investment funds are deployed under capital control regulations.

The latest clampdown is aimed at "irrational" cross-border acquisitions in view of the capital flight. The measures are aimed to ban investments on gambling and sex industry; restrict investments such as property, hotels, film, entertainment and sports; encourage investments that enhance the One Belt One Road Initiative. In addition, companies are required to prove that their overseas investments are directly related to their "core" business.

Since a large amount of overseas investments were for real assets, the real estate sector is experiencing the most direct impact. According to the Ministry of Commerce of the People's Republic of China, after a record of $103 billion (Mitchell & Wildau, 2017) worth of foreign assets in 2016, 2017 has seen a plummeting Chinese outbound investments due to the capital control. This is the biggest fall since 2009 – a 45 per cent decline in the first seven months of 2017 (Sidders & Chan, 2017). The sector is now expecting $58 billion to be deployed into the market between 2016 and 2020, a 50 per cent decline from the $110 billion total investment between 2010 and 2016 (Rosen, Margon, Sakamoto, & Taylor, 2016).

Another restricted sector is finance trading. MSCI, a New York based index compiler, announced the plan to add 222 mainland-listed companies to its benchmark emerging markets index gradually starting 2018, through which international investors could get access to the Mainland China equity market which has a market worth of $7.3 trillion for A-shares as of 2017. However, the restriction on capital flows, by way of a three-month repatriation waiting period after remittance via QFII, on top of the monthly repatriation capped at 20% of total assets, have caused concerns for international investors before they would actually include China stock shares in portfolios (Zhang, 2017).

Besides the impact on institutional investors on corporate deals, retail investors are faced with additional challenges on remittances for overseas assets. The "loophole" of the $50,000 limit is closed since pooling funds (known as "smurfing") is banned. New regulations require that besides the $50,000 per year currency exchange quota, investors must disclose their plans on use the funds. The punishment for any violation is government investigation, put on government watch list or three years' ban from transferring money. Other channels including borrowing loans denominated in foreign currency such as dollars but replaying in Renminbi, or investment in insurance policies overseas are banned as well.

Despite that Renminbi has fallen out of the top five currencies in international trades with a declined payments by 26% from 2016, according to GTR in August 2017, the foreign reserves have picked up since early 2017 due to the capital control and depreciation of dollars (Bermingham, 2017).

With the pressure on Renminbi alleviated, cross-border investments deals, however, have been curbed dramatically. This is a deviation from the considerable efforts built up in the past years in promoting China in the global market. This event may be temporary for now but will be repeated in the future.

5. TAPPING INTO THE CHINESE CAPITAL

China-based investors utilized different channels to make overseas investments through programs and schemes discussed in Chapter 3. Despite the headwind of capital control regulations, China continued to be the major source of capital in the commercial real estate capital market in Asia pacific in first half of 2017, according to CBRE Research. It is believed that there is a substantial volume of Chinese capital already circulating overseas based on the discrepancies between official data and actual investment turnover. Under the current control regulations, possible channels to continue to engage with Chinese capital include:

Existing offshore capital circulating overseas: throughout years, larger institutional investors or developers such as Greenland Group raised capital offshore by listing stocks on Hong Kong Stock Exchange and New York Stock Exchange. Other companies such as HNA, are able to reinvest proceeds from existing projects by establishing offshore offices and recruiting local teams.

Investing through Hong Kong: the city is special in its connection to the Mainland. As the designated Renminbi hub and the establishment of the Stock Connect, Hong Kong remains a solid platform for cross-border investments. Under the current capital control regulations, investing through stock exchange is still viable.

Limited partnership in a joint venture: due to the cap of capital in investments, China-based investors could opt to participate as a limited partner in a joint venture or take on smaller scale projects. Investors should be cautious of the investment amount since any amount higher than \$5 million would require disclosure of detailed information and higher than \$10 billion would require sign-off by government authorities.

In the short term, certain changes in terms of investors' profile and direction of capital will also be expected. Since large scale deals on trophy assets easily attract the scrutiny of the Chinese authorities, the participation of China SOEs will slow down, which coincides with the issuance of directives by the Finance Ministry of China to rein in debt of SOEs (Balding, 2017). According to CBRE (Chin, 2017), the major players are more towards sovereign wealth funds (SWFs) and private funds.

Figure 3. *Overseas Property Acquisitions by Chinese Investors*

Investors' Profile	Turnover (H1 2017, Year-on-Year)
SOEs	66% decrease
Private Equity	102% increase
SWFs	1932% increase

Source: CBRE Research

With the One Belt One Road Initiative (OBOR) that aims to improve the connectivity of China and Europe, the capital outflow is being also directed to OBOR countries.

In summary, both institutional and retail (individual) investors are affected in terms of the amount of capital that could be deployed, the changing profile of remaining players and the investment strategies. In the long term, China is still on the trajectory of liberalizing the economy and currency. However, because of the policy-driven nature of the economy, capital control regulations will be placed multiple times during its economic development. As a result, it is well-worth understanding how to sustainably collaborate with Chinese investors. The following chapters will explore this possibility through the platform of Hong Kong.

6. A STRATEGIC LOCATION – HONG KONG

Hong Kong Special Administrative Region of China is unique for its mix of traditional Chinese and Western culture. Globally recognized as an international financial center with a relatively free economy, Hong Kong is designated as the offshore Renminbi hub and the gateway for China market to connect to the global market. Famous for its competitive tax regime and geographical proximity, Hong Kong is usually the very first market where Chinese companies set up overseas offices. Not only attractive to Chinese investors, according to Boston Consulting Group June 2017, Hong Kong will attract wealth from overseas twice the pace of Switzerland in the coming four years benefiting from a fast expanding Asia economy and increasing number of millionaires – making it one of the best business regimes. Hong Kong will further see wealth from abroad including the Mainland China rising at a 7% compound annual rate through 2021. Despite the clampdown of hidden offshore assets by government authorities worldwide, wealthy people have not repatriated their undeclared assets even under tightened tax regulations for reasons such as concerns over political instability and preservation of wealthy from a slowing down economy growth.

Crediting to the confidence of investors worldwide and acting as a channel to connect China and the global market, Hong Kong will remain as a strategic position in the time of capital control. The deployment of capital will be continued through Hong Kong domiciled companies and via the Stock Connect.

7. OFFSHORE OFFICES AND FINANCIAL INSTITUTIONS

The Chinese capital can be accessed through entities with established offshore offices. These offices are usually in a small scale, with a primary objective of testing overseas market. Hong Kong is where these entities start off for its geographic proximity, culture connection while with a relatively free economy and minimal political influence from the Chinese government. HNA, Bank of China and CITIC are only a few of many Chinese financial institutions with established offshore offices in Hong Kong.

Hong Kong is a transit hub for Chinese companies to list their companies so that they could raise funds denominated in foreign currencies such as US Dollars and Hong Kong Dollars. Chinese companies domestically based could also raise funds denominated in foreign currency if aiming to attract overseas investors. However, it is the challenge from repatriating profits process that deters foreign capital to flow into China unless foreign investors such as Gaw Capital are determined in a long-term expansion in the Mainland China market. In addition to the benefit of hedging against currency fluctuation, setting up headquarters in Hong Kong is also a strategic move for further overseas expansion. The offices are able to deploy capital already circulating overseas by reinvesting proceeds from existing projects or profits from stock markets. However, if they are part of SOEs, they may also be influenced by the current capital control.

More established offshore companies may already be based in Western markets such as New York City and London. Entities including Vanke, Gemdale etc. have already recruited strong local teams and established a track record with transitioning strategy to perform more general partner's responsibilities. Being able to profit from larger scale projects overseas, these companies are more independent and less influenced by China policies, although not completely free.

8. PRIVATE EQUITY FIRMS

The concern of Renminbi devaluation against the backdrop of efforts of liberalizing the currency by the government authorities is the major reason for the recent capital flight. Through the past few years, a considerably large amount of capital already parked outside of China, in Hong Kong and overseas mostly in the form of real estate investments. There are many boutique private equity firms with cash-rich Asian clients actively looking at deals overseas and participating as equity partners. These kind of firms are characterized with lean in size and mostly opportunistic – actively seeking yield and not constrained geographically.

A lot of these funds are conveniently located in Hong Kong for reasons such as there is a strong connection of the Mainland and Hong Kong (gateway to international market); and as more and more business is drawn from China, the business environment is easier to understand therefore less barrier to establish trust. In fact, based on the opinions of industry professionals, it is more challenging to deploy abundant capital for a lack of high quality deals rather than insufficient capital source. The high prices in major markets such as Hong Kong, New York, San Francisco etc. and a low interest rate environment globally have resulted in excess liquidity.

A typical investment deal by private equity firms include the process of deal sourcing, due diligence, acquisition, post-acquisition monitoring, and exit. The following is a brief description on how to do a deal and how to mitigate risks in cross-border transactions.

Private equity investments start with sourcing deals, which is either through property owners directly approaching investors or through an intermediary who connects both parties. An investment manager may come across hundreds of potential deals but only select a few by checking key numbers such as going-in capitalization rate and cash on cash yield through back of envelope calculations and then they proceed to the next stage – due diligence[8]. This stage is an effort by the investment managers to work side by side with accountants, consultants on financial, tax, legal issues to make sure that all details are collected for later stage negotiations. The time it takes for the due diligence process is based on the scale, complexity of a deal and the competition between investors. But it is also an ongoing process weaved into all stages with more information being requested for negotiations, drafting contracts and selection of sub-contractors such as designers and operators. During the negotiation stage, terms and conditions are discussed so that contracts can be put together. The next part is the deal closing which includes the conclusion of the deal, signing of all agreements. Post-acquisition includes renovation, asset management depending the nature of the investment and holding period. Financial reporting and governance are made periodically during this period. The last stage is exit. Exit mechanisms depending on investors' objectives should have been thought through from the start in order to structure the deal properly. Investors may look to long-term holding, have considerations for tax deference through refinancing, aim to maximize internal rate of returns (IRRs) or maximize payoff multiple on invested capital instead of IRRs. In matching with these objectives, exit strategies could be partner buyouts or a forced sale to an independent third party, which come in many forms such as transacting at a pre-agreed premium, mutual agreement to refinance or go public. The profit will be returned to investors after taking out fees for investment managers.

When structuring a deal, it is important to mitigate risks. The protection can be enhanced through a general partner having "skin in the game" and counterparty contributing nominal equity, providing guarantees and including clawbacks clauses. The partnership should be based on transparency, clearly defined fee structure and control provisions.

[8] A due diligence checklist based on Harvard Business School Real Property is attached in the appendices.

After understanding the process of making a deal and mitigation of risks, cross-border investors should in addition be aware of their lack of control and knowledge of a local market for practical reasons such as long distances and language barrier, which may cause them to overly rely on the expertise and good faith of a local partner and a counterparty. Careful considerations should also be given to currency risks.

Under the capital control regime, despite existing capital committed to certain funds, China-based investors may be more inclined to participate as equity partners with lower contribution amount, and opt for safer deals with lower costs and risks in view of uncertain timeline of the capital control in place, compared to when it was easier to move around capital.

9. INVESTING THROUGH HONG KONG

i. Hong Kong Investors

Hong Kong-based investors[9] have been over shadowed by the China-based investors who made their names by aggressively acquiring trophy assets overseas. However, the Hong Kong local group comprise the most sophisticated and extremely wealthy investors who have built real estate empires not just confined to Hong Kong. The acquisitions of the Nine Elms Square and the "Cheesegrater" 122 Leadenhall Street, and "Walkie-talkie" 20 Fenchurch Street in London earlier this year by Hong Kong related investors brought back attention to this group.

The capital control that resulted in a dramatic decline of overseas property investment has also lowered the China-based investors' frantic land biddings and office building purchases for business expansion in Hong Kong where record high prices were seen more frequently than ever. The China-based groups started to invest in Hong Kong around 2010, and bought 30% of all the land sold by the government in Hong Kong in 2016 (Mcmillan, 2017). According to Jones Lang LaSalle, in the first half of 2017, the China-based investors only accounted for 7.6 per cent of the total investment volume in the office sector of Hong Kong, compared to 31 per cent last year. The China-based investors were also absent in bidding for the most valuable commercial land in Murray Road Central due to the tightened remittance process on capital outflow.

Like other foreign investors, despite positive long-term view of the Mainland China, Hong Kong-based investors are concerned about profits repatriation once business is set up in China. As a result, more investors are prone to investing in ex-China overseas markets. In fact, the difficulties

[9] In this chapter, investors broadly include developers despite two groups assume different level of risks and have different area of expertise.

faced by China-based investors turned out to be an opportunity for Hong Kong-based investors who used to be priced out in the fierce competition. Overseas investors may find themselves in partnership with Hong Kong-based investors in more deals in the near future, and Hong Kong real estate market is seeing signs of more rational transaction pricings.

ii. Hong Kong Stock Exchange

The potential opportunities to engage Chinese capital through Hong Kong platform under capital control are twofold, both via the Hong Kong Stock Exchange.

First, while the world was courting Chinese developers, it neglected the Hong Kong developers whose real estate business has been one of the supporting industries of Hong Kong economy. With a relatively free economy, the investment strategies are mostly market-driven. Top developers are listed on the stock exchange where Chinese nationals could trade shares within the regulation of Stock Connect. The top five of the developers on the lists include:

Figure 4. Top Ten Developers listed on Stock Connect and Portfolio Presence

Stock Code	Stock Name (Chinese)	Stock Name (English)	Investment Overseas	Investment China	Interest in REITs
01113	长实集团	CK ASSET	Yes	Yes	Yes
00004	九龙仓集团	WHARF HOLDINGS	Yes	Yes	No
00012	恒基地产	HENDERSON LAND	No	Yes	Yes
00016	新鸿基地产	SHK PPT	No	Yes	No
00017	新世界发展	NEW WORLD DEV	No	Yes	No
01972	太古地产	SWIREPROPERTIES	Yes	Yes	No

Source: HKEx

The existing control by PBOC new cap on the amounts that companies can invest overseas, i.e. no more than 30% of their equities stakes, will not affect the Stock Connect, according to HKEx. As discussed in Chapter 3, the mechanism of the Stock Connect ensures that capital flight will not happen within this closed loop. Therefore, the Hong Kong listed companies are still able to continue their cross-border investments if they are based out of Mainland China. For example, the abovementioned developers could deploy their investors' capital for overseas asset acquisitions without being scrutinized whether the capital source is Chinese national in Mainland. Out of the many programs mentioned in Chapter 3, the Stock Connect is one of the few that is not affected by the capital control regulations. In fact, due to the strong demand of Hong Kong stocks from Chinese investors, the Hong Kong Monetary Authority has just renewed the terms of the existing seven banks by expanding its Primary Liquidity Providers scheme, to facilitate the process and ensure that the banking system is able to manage the Renminbi liquidity. Through Stock Connect, Chinese investors continue with their cross-border investments in Hong Kong stocks subject to the daily quotas or other overseas markets through Hong Kong listed companies.

The second promising channel related to the stock exchange on cross-border investments lies in the possibility of approving of the Real Estate Investment Trust (REIT) stocks eligibility in the program. According to the Hong Kong Stock Exchange, a REIT is "a collective investment scheme that aims to deliver a source of recurrent income to investors through focused investment in a portfolio of income-generating properties such as shopping malls, offices, hotels and service apartments in Hong Kong and/or overseas." (HKEx, 2011)

The REITs provide investors with stable and regular income. The existing Securities and Futures Commission (SFC) regulations require a dividend payout ratio no lower than 90 per cent, net of tax basis. The trade of REITs stocks is similar to other securities other than the underlying assets are real estate.

Based on a thesis by King Man Chow on Hong Kong REITs market, the market with a total of eight listed REITs is lagged behind others in the region. Chow's study uncovered a number of reasons including abundant liquidity, low yields, a lack of enhancement mechanisms etc. which led to an underdeveloped REITs market with insufficient supply and suppressed demand. Chow further suggests that the remedy lies in the cross-border deals where listed Hong Kong REITs are backed by assets in China where higher yields still exist (Chow, 2011). Fast forward to 2017, one additional REIT was launched - HUI XIAN REIT. Below is a list of REITs in Hong Kong.

Figure 5. *List of REITs*

Stock Code	Name of Listed Securities	Unit Trusts/Fund Manager
00405	GZI REIT	GZI REIT Asset Management Ltd.
00435	SUNLIGHT REIT	Henderson Sunlight Asset Management Ltd.
00625	RREEF CCT REIT	RREEF China REIT Management Ltd.
00778	FORTUNE REIT	ARA Asset Management (Fortune) Ltd.
00808	PROSPERITY REIT	ARA Asset Management (Prosperity) Ltd.
00823	LINK REIT	The Link Management Ltd.
01881	REGAL REIT	Regal Portfolio Management Ltd.
02778	CHAMPION REIT	Eagle Asset Management (CP) Ltd.
87001	HUI XIAN REIT	Hui Xian Asset Management Ltd.

Source: HKEx

Out of the total nine REITs listed, one third is China assets backed. They are GZI, RREEF CCT and HUIXIAN. The detailed mechanisms of a REIT are not discussed here. However, REITs as a modern financial instrument is strongly demanded in both Mainland China and Hong Kong. With the expansion of REITs market, asset managers will very likely start to include overseas assets other than Hong Kong and Mainland China assets. The REITs could provide a channel to access Chinese capital through exiting a deal as a REIT listed in Hong Kong, despite the physical allocation of an asset. However, the REITs stocks at the moment are not included as eligible for Stock Connect which is still in its infancy as a financial platform. With the slowly inclusion of ETFs, other products such as REITs, bonds should be considered and approved with a more comprehensive system set up within the Stock Connect program. The potential of REITs being included in the future could not only allow capital flowing in both markets, but also stimulate positive growth of the REITs market in Greater China.

iii. Conclusions

Under the capital control, Hong Kong-based investors may start to regain the attention of the global market. Hong Kong is not only home to ample number of sophisticated investors who have large portfolios of overseas asset but also provides a channel by way of stocks listed on Hong Kong Stock Exchange to continue to allow access to China-based investors' capital. With the scope of eligible stocks further to expand, REITs may follow ETFs which is soon to be incorporated be eligible for cross-border investments. This would provide additional opportunities for partnership with Hong Kong-based developers and asset managers, and exit options for overseas real estate deals.

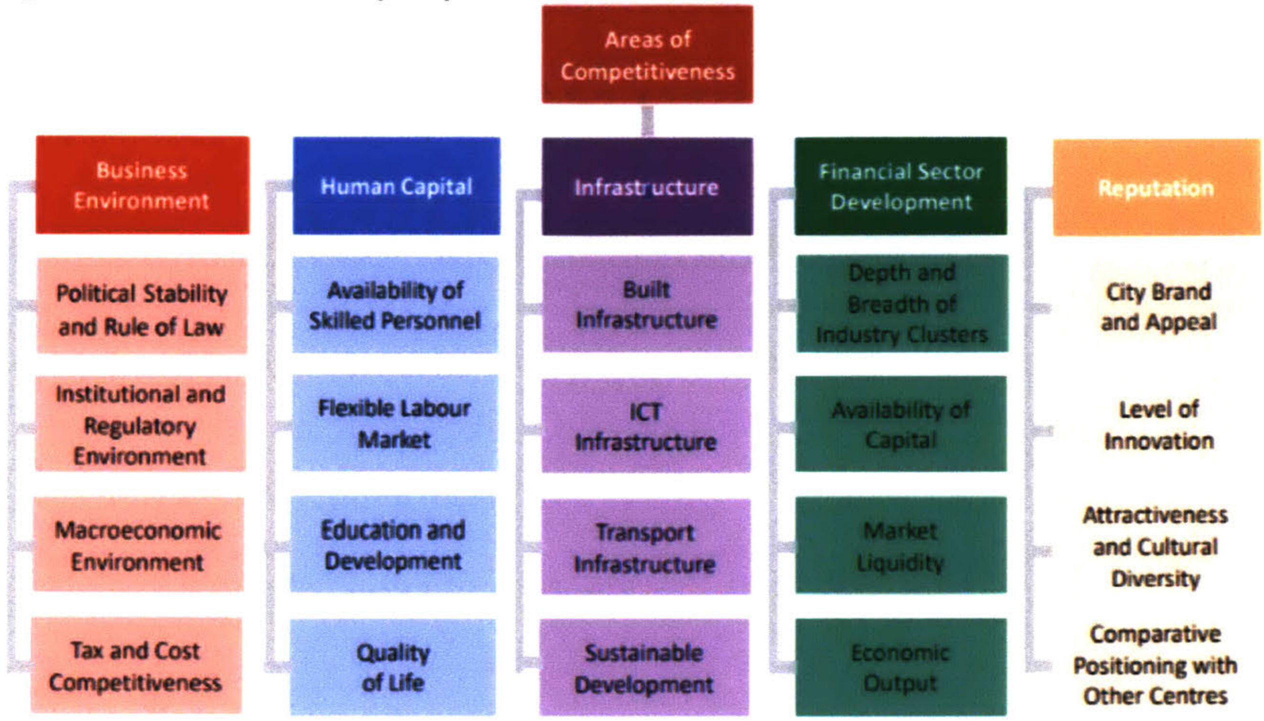
10. WHY AND WHERE MATTER

Understanding the critical position of Hong Kong could be helpful in creating a sustainable business strategy for cross-border investments between China and Western markets, especially when the restriction of capital movement will not be a single event for a policy-driven economy. The following case studies for London as a continued attraction for Chinese capital and Boston as an up-and-coming cross-border investments destination are researched to provide evidence and suggestions.

i. London

Based on The Global Financial Centres Index (CFGI) by CDI and Y/Zen September 2017, London kept its crown as the number one world financial center (Yeandle, 2017). The GFCI is an index compiled based on 102 instrumental factors which were provided through third parties such as the World Bank and the United Nations. The factors assessed were based on questionnaires from over 3,000 respondents. The results indicated that London is considered most competitive in five areas: business environment, human capital, infrastructure, financial sector development and reputation. More details on these five areas and top 10 cities can be found in Figures 6 and 7.

Figure 6. GFCI 22 Areas of Competitiveness



Source: The Global Financial Centres Index 22

Figure 7. GFCI 22 Top 10 by Area of Competitiveness

Rank	Financial Development Reputation	Business Sector	Environment	Human Capital	Infrastructure
1	London	London	London	London	London
2	New York	New York	New York	New York	Hong Kong
3	Hong Kong	Hong Kong	Hong Kong	Hong Kong	Singapore
4	Singapore	Singapore	Singapore	Singapore	New York
5	Shanghai	Shanghai	Shanghai	Shanghai	Tokyo
6	Tokyo	Frankfurt	Beijing	Tokyo	Dubai
7	Frankfurt	Zurich	Tokyo	Beijing	Shanghai
8	Chicago	Beijing	Frankfurt	Boston	Stockholm
9	Zurich	Tokyo	Boston	Chicago	Frankfurt
10	Boston	Luxembourg	San Francisco	San Francisco	Toronto

Source: The Global Financial Centres Index 22

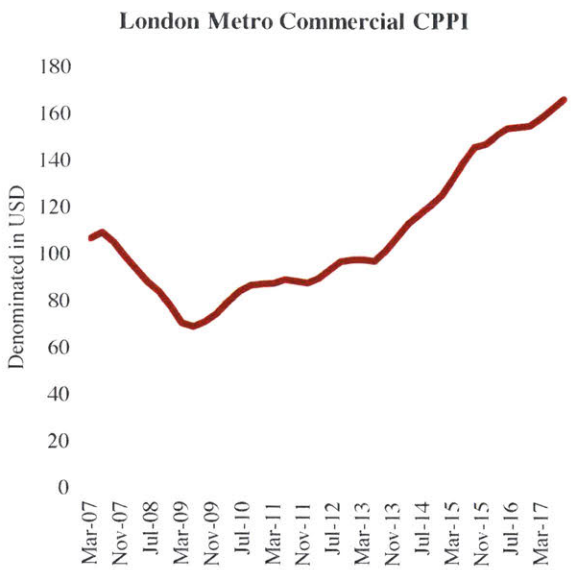
The competitiveness of London extends to the real estate market, which makes it the top international investment target market by investors including those from China and Hong Kong. However, since 2016, London has been a cross-border investments destination that seems to require careful consideration under Brexit.

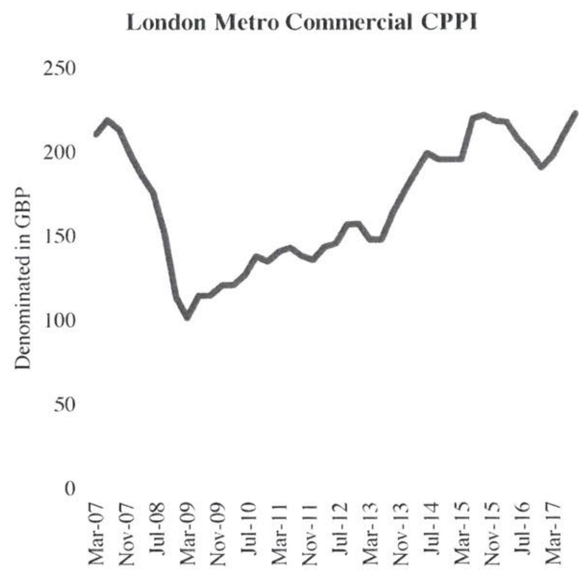
Investors who continue to participate in the market are looking in effect for discounted pricing due to a depreciating Great Britain Pound (GBP) and tend to hold a medium- to long-term position in the market. Investors who are on the lookout are more concerned about uncertainties in the outcome of a "Hard Brexit", which would result in Britain exiting the European Single Market. The relocation of major financial institutions' headquarters such as Goldman Sachs, Bank of America, and Bank of China to its European Union (EU) counterparties such as Frankfurt, Dublin, and Paris is already happening. To add to the uncertainties, during an earlier snap general election called by the Prime Minister Teresa May in June 2017, the Conservative Party led by Ms. May who has strong stance on a "Hard Brexit" surprisingly lost the majority seats. As a result, a "Hung Parliament" situation makes it more unpredictable how the future of Britain will unfold.

In addition, based on the most recent Gross Domestic Product (GDP) data by the Office for National Statistics, the year-on-year GDP growth for the third quarter 2017 was 1.5% with the quarter-on-quarter growth rate stood at 0.4%, remaining consistently sluggish with previous quarters.

In contrast to the unpredictable political events and underperforming GDP growth, tourism and the property market seem to perform remarkably well. According to the latest tourism statistics from VisitBritain, the U.K. welcomed more than 11 million visitors between July and September 2017 (4% growth year-on-year). There were 30.2 million inbound visitors in the first nine months which led to a record visitors' spending of £18.7 billion (9% growth year-on-year) since record began in 2003. On the property market front, according to Savills, investors' appetite remains strong and is concentrated on income generating assets in prime location such as regional hotels and food stores. As a result, yield compression in all sector returned to the property market in the third quarter. The boosting tourism due to a weakened GBP and robust investment sentiment backed by strong fundaments are likely to prompt London property market for further growth, despite concerns over Brexit. Below charts are price changes over years for London metro commercial property price indexes denominated in the USD as well as GBP. The property market rebounded not long after the announcement of Brexit and keep trending up.

Figure 8. *London Commercial Property Price Index*





Source: Real Capital Analytics, IMF

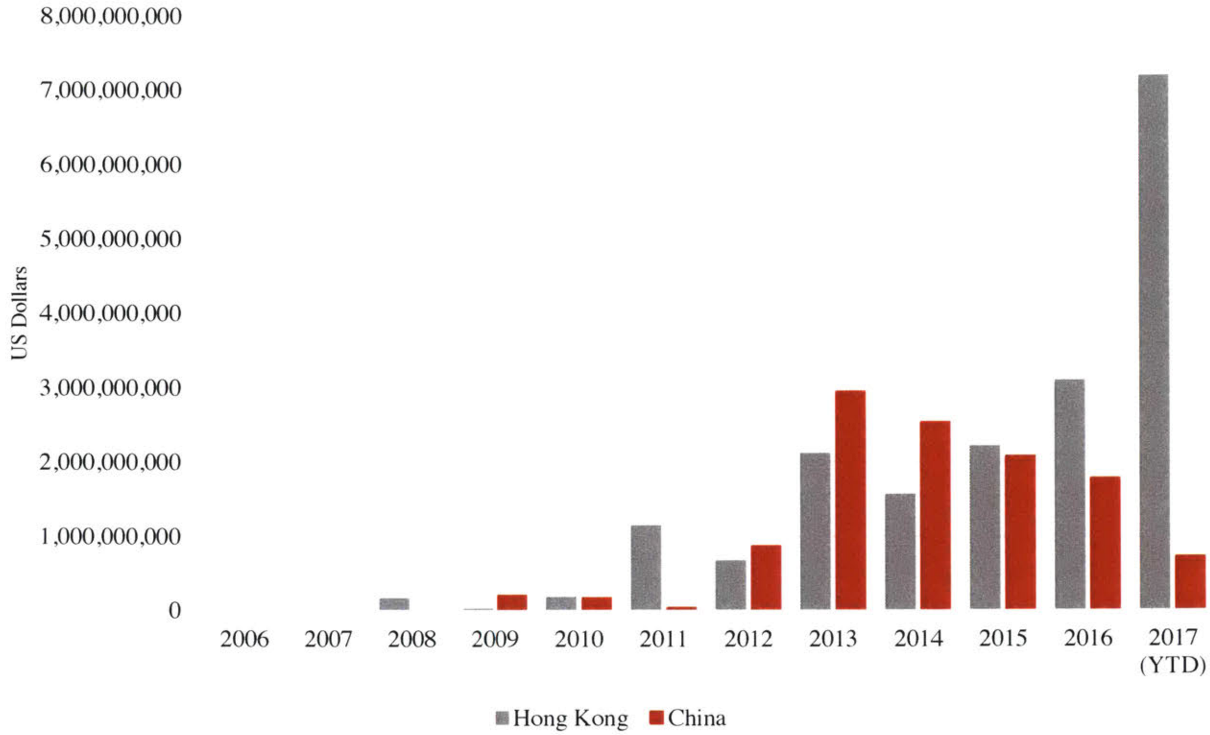
The strong property market against the backdrop of an uncertain Britain political transition creates a unique point of time for cross-border investors who look over the medium to long term.

Meanwhile, Jones Lang LaSalle in the most recent report on global capital flow concluded that London ($17.5 billion, H1 2017) again surpassed New York ($11.2 billion, H1 2017) ranked the most traded city in terms of cross-border investments where Hong Kong and Germany investors accounted for 60% of all foreign investment.

Indeed, the headlines that Hong Kong investors made over the past few months were almost all related to transactions in London market. There are a few reasons why Hong Kong would choose London despite the uncertainties of Brexit: cheaper price due to weaker GBP (although still at premium in London), a historical close bond between the Britain and its former colony which makes it easier to collaborate in terms of culture and language, and a need to allocate capital outside the Greater China region for concern of the possible political risks in 2047 once the One Country Two Systems constitutional principle is set to expire. On the other hand, the local partners in London also have very deep knowledge about Hong Kong and the investors. This mutual understanding makes it particularly attractive to channel Hong Kong-based capital to London.

In terms of the preference of Hong Kong investors, based on existing transactions, office buildings have been acquired: Aldwych House (175,000 sf at £250 million), 122 Leadenhall (909,000 sf, 1.15 billion), 20 Fenchurch Street (669,000 sf, £1.28 billion). It is evident that Hong Kong investors are prudent to target on long-term income generating assets while the large scale properties in premium location also achieve a branding purpose. The investment strategy also rules out residential properties because the capital gain tax is between 18 and 28 per cent (depending on the size of gain, rental income etc.) for residential properties transacted by non-resident after October 6, 2016. Commercial property is exempted from such tax for non-UK entities (BLP, 2017). Below is a table of transaction volume by Hong Kong and China-based investors.

Figure 9. *London Cross-border Investment Analysis*



Source: Real Capital Analytics

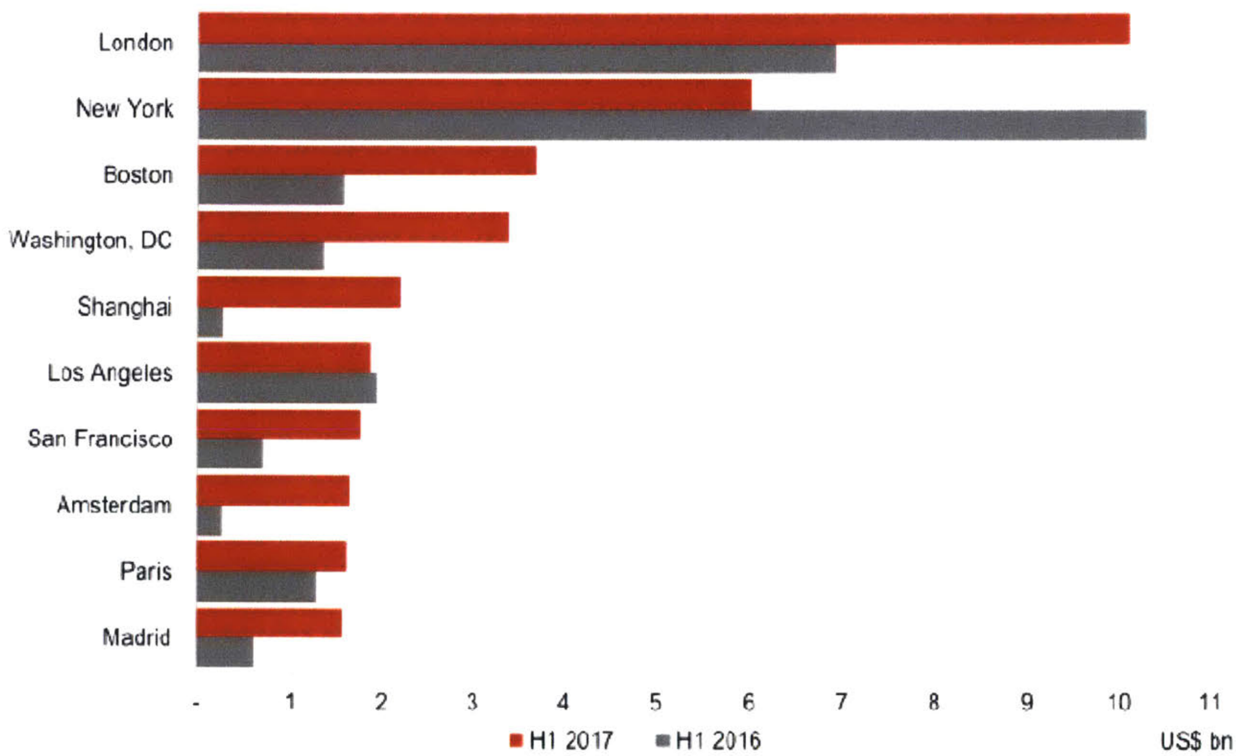
Based on the data from RCA, the sudden spike of Hong Kong capital in the market even just for the first 10 months of 2017 is remarkable, compared to a decreasing involvement of China-based investors. The increased activities by Hong Kong-based investors is a result of timing of Brexit and long-held concern over the One Country Two Systems.

While London has been enjoying investors' confidence especially in finance and property markets despite Brexit, the forthcoming two years of Brexit negotiation period could bring about more uncertainties. Nevertheless, it now seems more likely that London will continue to see global investments flowing into the market, provided that currency and tax and regulation factors remain favorable to foreign investors. London-based asset managers could even consider listing REITs in the Hong Kong Stock Exchange to strengthen its tie with Hong Kong-based or even broader range of Asian investors and benefit from the international-standard transparent business and legal environment. Meanwhile, more exits through REITs in Hong Kong could help deepen the REITs products market in Hong Kong.

ii. Boston

Boston stands out for it was ranked third place globally for receiving more than $3.7 billion (£2.8 billion) cross-border investment in the first half of 2017. While way behind London and New York City, both London and Boston are looking at increased investment trend while New York City recorded dramatic decrease based on the same report by Jones Land LaSalle.

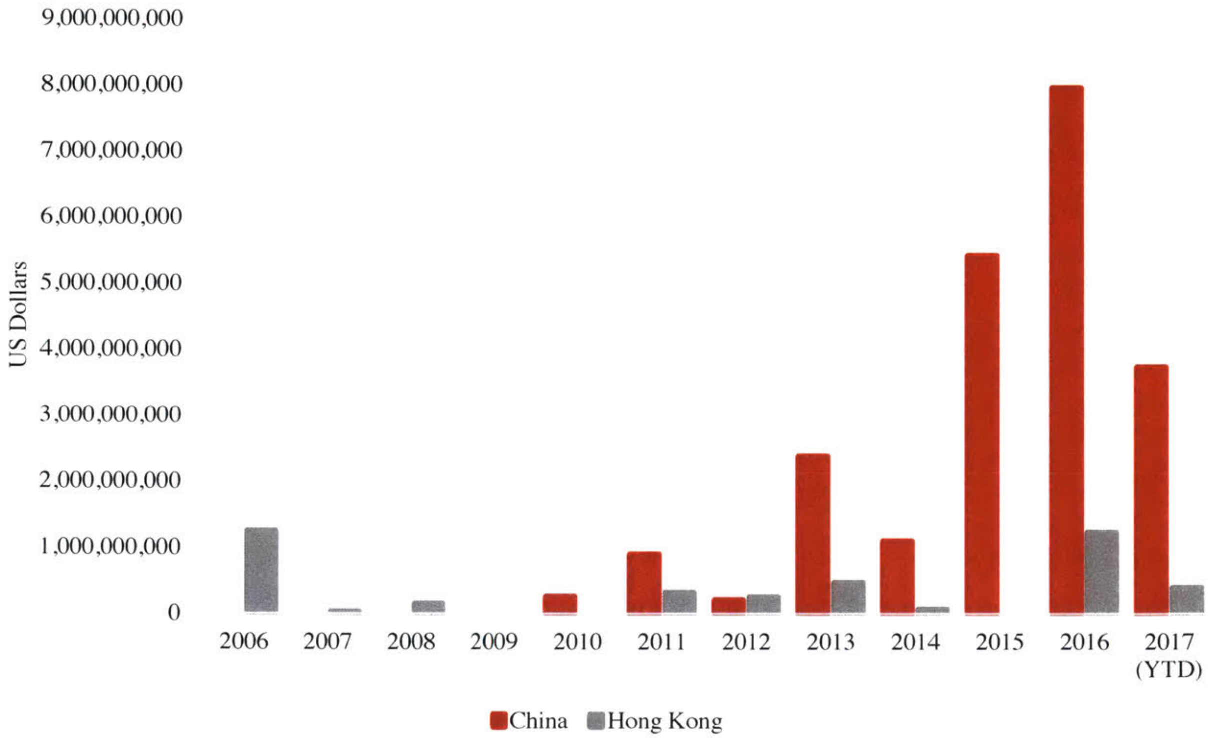
Figure 10. *Top 10 recipient cities of cross-border investment*



Source: Jones Lang LaSalle

The drastic decrease of cross-border investment in New York City is likely to result from the retreat of Chinese investors, based on RCA data.

Figure 11. *NYC Cross-border Investment Analysis*



Source: Real Capital Analytics

Boston's gaining popularity in contrast to the decline of other major gateway cities in the US may be due to its supply of education institutes. The economy of Greater Boston Area is supported by 35 colleges and universities such as Massachusetts Institute of Technology and Harvard University, and 22 hospitals such as Massachusetts General Hospital and Boston Children's Hospital. The employees in the education and health services are as much as 21% of total employment, compared to an average of 15.6% for the U.S. as of July 2017 according to Bureau of Labor Statistics. These sectors are less affected by the economy cycles, probably could even hedge the underperformance of other sectors. Therefore, during a time of concern over the US economy and property market, Boston stands out for its solid economy fundamentals. In fact, during a slumping economy, the number of people going back to school usually increases. As a result, Boston offers good prospects to be able to survive the volatility of market changes should that happen in the near future.

In addition, one major reason for investors to decide their investments is to gain access to prominent education institutes for their children. Housing purchase could be for investment or self-use purposes. As a result, investors' preference for Boston market is long-term and for education purpose. Supporting real estate asset types including sports centers and student housing could benefit.

Boston, despite not yet being a global city as London and New York City, will continue to gain popularity among Chinese investors. Boston could accommodate their strong appetite for asset diversification as an outstanding education hub and medical center, as well as better economic prospect should the market be already at or near its peak and heading into a correction. However, local partners, with a long-term view, should be aware of possible abrupt retreat of China-based investors under strong influence of domestic policy and play to its advantage to attract Hong Kong-based investors.

11. SUMMARY

This thesis starts with a brief introduction of the ample efforts put forward by China to liberalize its economy and currency as the second largest economy in the world. However, this much welcomed attempt is constrained by capital control regulations created in the recent year to halt the capital flight and stabilize the alarmingly low level of foreign reserve.

Despite some temporary roadblocks in continuing the utilization of existing channels including the Qualified Domestic Institutional Investor Scheme and the Qualified Domestic Limited Partner in the Shanghai Free Trade Zone, the new quotas and delayed approval process will be relaxed in the long term. This is mainly due to the characteristics of a policy-driven economy where a steady "long-term goal" is set but occasional governmental influence is applied to prevent any deviation from this goal which would be the liberalization of the economy and currency. Therefore, players in Western markets will be in a better position if they continue to deepen their understanding of these programs while planning strategic partnership to mitigate policy risks. With this, a sustainable business strategy to collaborate with Chinese investors would utilize investment channels via Hong Kong – a special administrative region of China. This former British colony still serves as a unique platform providing a key gateway to overseas investments. China-based capital remains accessible by partnering with Hong Kong-based offshore offices and private equity firms, Hong Kong-based investors, and stock investments under the Stock Connect program.

It should also be noted that the capital control regulations by China are more of a means to direct the capital to promoted industries and markets aligned with the "long-term goal" than to curtail capital outflow altogether. The Stock Connect program reinforces the identity of Hong

Kong as a financial center to China and the world, strengthens business relations with Hong Kong-based developers, deepens the development of the REITs market if this product is to be incorporated in the program, and furthermore provides an additional exit option for deals. The promotion of the One Belt One Road Initiative suggests that there will be more investments on infrastructure projects along the two designated routes-the Silk Road Economic Belt and the 21st Century Maritime Silk Road.

Due to the strategic role of Hong Kong and the retreat of directly competing China-based investors, Hong Kong-based investors have been making aggressive acquisitions in Western markets. The remaining Chinese investors are less likely to be state-owned enterprises but rather private equity firms with capital circulating outside China, and sovereign wealth funds. This shift of investors' profile is especially evident in the London market due to their historical bond and a discounted price from the depreciation of Great Britain Pound. This trend will continue with a strong demand of overseas real assets by Asian investors who aim to diversify their investment portfolios and look for long-term returns.

In addition, the market will see increasing smaller deals or limited partners by China-based investors with under $10 billion equity contribution if governmental scrutiny is not in the best interests of time sensitive projects. This behavior is in contrast to Hong Kong-based investors, who may continue large-scale acquisitions in the absence of competition. Meanwhile, Western market players may utilize this unique point of time to take over deals involving retreating China-based investors who are at the risk of default due to difficulty in fulfilling financing requirements.

Due to the historical bond, cheaper currency and concerns over the expiration of the One Country Two Systems policy, Hong Kong-based investors seem to prefer the London market. China-based investors do not show such preferences. Boston, opposite to the declining investment volume in the traditional gateway cities such as New York City, leapt to third place in the top ten receiving cities of cross-border capital in the first half of 2017. It is not difficult to rationalize this shift due to the abundant educational institutions which not only mitigate economic risks during market downturns but also provide access to a top level education. This combination is greatly valued by both retail (individual) and institutional investors. However, Boston as an up-and-coming global city, could be faced with competition for Hong Kong capital against London, and with the uncertainties from China-based investors who used to snatch the luxurious condominiums before the capital control regulations.

To summarize, by reviewing existing programs in place to facilitate the liberalization of the economy and currency and revisiting the unique position of Hong Kong, this thesis reveals changes in investors' profiles and suggests strategies that Western market players can adopt to continue their collaboration on cross-border investments with investors from China.

To expand, capital controls taking the forms of outright prohibition, quotas on capital amount or tax structures, are not uncommon especially for emerging markets such as China, Brazil, India, Malaysia and many others that still impose exchange rate intervention. Despite various downsides, through well-planned manners, the regulations could be effective in maintaining a healthy trade deficit by maintaining currencies close to their intrinsic values; and protecting underdeveloped financial systems from devastating busts of borrowing booms during severe capital outflows. Therefore, close attention to currency fluctuations, understanding of the maturity of markets, and knowledge of existing or potential capital flow channels could provide good indicators of forthcoming investment dynamics for cross-border investments with policy-driven economies.

12. APPENDICES & REFERENCES

Appendices:

Due Diligence Checklist

	START UP:
1	Preliminary inquiries
	- Flood zone - get elevation survey if Flood Zone A
	- Environmental issues/ asbestos
	- Physical issues/roof/seismic
	- Leasing – rollovers, Termination options, Options
2	Prepare preliminary Argus run
3	Obtain written proposals from third party consultants
	- Environmental
	- Environmental Oversight review of proposal
	- Structural/ADA
	- Seismic (if applicable)
	- Roof
	- HVAC/ Mechanical Systems
	- Elevator
	- Tenant Credit
4	Obtain certificates of insurance from all third party consultants
5	Notify due diligence team
6	Prepare schedule of key dates
7	Obtain summary information - brochures, photos, maps, site/floor plans
	LEGAL, TITLE AND SURVEY:
1	Letter of intent
2	Purchase and Sale Agreement
3	Exhibits to Purchase and Sale Agreement
4	Post Deposit
5	Assignment of Purchase and Sale Agreement
6	Assignment of Leases and Rents
7	Deed
8	Preliminary Title Report
9	Review Title Exceptions
10	Final Title Policy
11	Review existing surveys

12	Review updated survey with certification - flood zone certifications? Elevation survey if in Flood Zone A?
13	Review reciprocal use easements and restriction agreements
14	Review owner's association documents
15	Review zoning
16	Zoning opinion from counsel if deemed necessary
17	Review financing documents if any
18	Review seller financial statements
19	Review ground lease documents if any
	PHYSICAL:
1	Obtain complete plans and specs
2	Obtain all available tenant improvement plans
3	Verify ceiling ht., floor slab, #/types of docks, turning radius, lighting systems (Industrial)
4	Verify # of parking spaces (survey)
5	Verify rentable/leasable sq. ft. (structural); - reconcile to rent roll
6	Obtain draft/final third party reports
	- Environmental
	- Environmental oversight letter
	- Structural
	- Seismic (if applicable)
	- ADA (as part of structural)
	- Roof
	- Market Studies
	- HVAC/ Mechanical Systems/ Chiller retrofit
	- Elevator
	- Sprinkler -code/adequacy
	- Parking Lot
7	Review any guarantees or warranties for building or systems
8	Review any construction documents, inspection reports
9	Prepare list of deferred maintenance items
10	Prepare list of capital expenditures required
11	Update Argus projections to reflect deferred maintenance. & capital items
12	Code compliance, notices of violations, possible code changes
13	Replacement cost analysis
	TENANCY AND LEASES:
1	Review all leases
2	Review all tenant correspondence & files

3	Compare leases to seller rent roll
4	Confirm security deposit amount for each tenant
5	Review schedule of concessions - TIs, free rent, lease buyouts, other
6	Tenant options - termination, renewal, rights of first refusal, expansion
7	Review major tenant financial statements (if available)
8	Alternative credit review for major tenants w/ insufficient financial info
9	Review historical accounts receivable information
10	Review parking requirements/reserved parking in leases
11	Tenant interviews
12	Tenant interview notes in file
13	Review tenant complaint file
15	Review tenant sales information (Retail)
16	Review historical percentage rents, % rent billings (Retail)
17	Review leasing status report from listing broker
18	Review standard lease form
19	Review op. covenants, recapture, co-tenancy clauses in leases (Retail)
20	Review scope of standard TIs
	FINANCIAL AND OPERATIONAL:
1	Review seller's current year operating budget
2	Review prior years' operating statements
3	Review year to date operating statements
4	Review CAM/other reimbursable expense billings
5	Review prior years capital expenditures
6	Review real estate taxes:
	- Assess impact of sale on real estate taxes
	- Engage consultant for real estate tax review
	- Review current and prior years real estate tax assessment notices
	- Bonds/ special assessments
7	Review utility invoices and utility reimbursements
8	Review personal property information
9	Review service contracts
10	Review any permits or licenses required to operate property
11	Review parking agreements (if any)
12	Verify parking income
13	Review antenna, cable or other special agreements
14	Review owners association documents, by-laws
15	Review union contracts
16	Review appraisal (if required)

	MARKET:
1	Tour competing properties
2	Perform study of competition and market rent comparables
3	Review competitive vacancy; market vacancy
4	Obtain general background information on market
5	Demographic analysis
6	Traffic counts (Retail)
7	Sales potential analysis (Retail)
8	Potential competition - planned/entitled projects
9	Building and land sale comps
	PRE-CLOSING:
1	Discuss capital requirements with accounting at least 30 days prior to close
2	Prepare prelim. investment summary for investment committee - should include photos, site plans, maps and Argus
3	Update minutes to reflect Board approval of deal
4	Obtain investment committee signatures on deal consent
5	Due diligence materials – oversight review
	- Final P and S
	- Environmental, with Environmental oversight letter
	- All engineering reports
	- Argus projections
6	Reconcile estoppels, leases/lease abstracts, Argus and rent roll attached to P and S
7	Management agreement
8	Leasing agreement
9	Notices to tenants re. change in ownership, management
10	Terminate/transfer service contracts
11	Utility cut-off
12	Transfer warranties
13	Obtain final versions of third party reports
14	Review settlement statement
	- Security deposits (plus interest if any)
	- Prorate rents, service contracts
	- Proper treatment of reimbursements
	- Verify real estate taxes; tax period
	- Return of deposit (plus interest)
	- Proper allocation of closing costs
	- Consulting fees - check proper documentation
	- Copy of final statement to accounting
	- No proration of receivables or payables

15	Review accounts receivable as of closing date
16	Reconfirm compliance with Investment Program. To Investment Committee for sign-off
17	Insurance enrollment form
18	Leases to asset management for input to data base
19	Prepare post-closing transition memo
20	Meet with asset management and accounting re: transition
21	Complete Investment Summary (within 30 days)
	POST-CLOSING:
1	Key documents to safe deposit box (deed, promissory notes)
2	Complete Investment Summary
3	Brochure quality photographs for investor mailing
4	All due diligence/closing bills paid
5	Closing/settlement statement to accounting
6	Re-proration clause in P & S - $ may be receivable/payable post-closing - put in tickler
7	Coordinate delivery of seller information to Prop. Mgr./Asset Management
8	Update all acquisitions info on data base
9	Prepare and distribute property fact sheet
10	Engineering reports, other insurance info to accounting – should include survey with Flood Zone/ Elevation certification if applicable
11	Determine land/building allocation

Source: Harvard Business School Real Property

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