

**Chinese Outbound Investments in the U.S. Real Estate Market:
Analysis and Perspectives**

by

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B.S., Finance and Economics, 2011

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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**

at the

Massachusetts Institute of Technology

September, 2016

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Center for Real Estate
July 14, 2016

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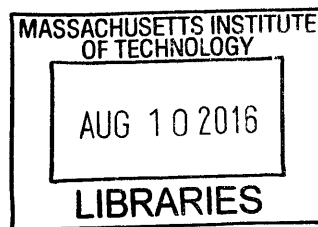
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ABSTRACT

Chinese outbound investments have expanded rapidly in recent years and drawn wide attention in the U.S. real estate market. Unlike previous waves of Chinese investment in the past two decades, this batch of capital inflow shows various types of institutional players investing in almost all property types across the U.S. through diversified and innovative deal structures, making headlines and striking record-price deals every few weeks. Chinese investors are also driven by different incentives besides seeking for yield and return, which is partially why the U.S. real estate space is seeing interesting dynamics in the deals and markets where these investors are active in. I would like to take a deep-dive study into these outbound investment initiatives and systematically explore the key opportunities, trends and issues. For this essay, I would like to focus on the institutional side of Chinese investments, namely investments made by capital management platforms or corporates, rather than personal and family office investments into ultra-luxury houses or retail investments through EB-5 programs. As there are limited public data points recorded for executed acquisitions available to assist deep-level exploration, partially due to the relatively small transaction volume in fixed asset space, we decided to implement interview and case study approach in order to obtain front-line view of the potential trends and opportunities.

This essay starts with a general overview of China's macro fundamentals and Chinese outbound investments across all destination countries and industry sectors, then analyzes the various aspects of Chinese capital in the U.S. real estate market, including size, structures, geographic breakdown, property type breakdown and key investor types supported by case studies of each investor type. The detailed transaction analysis and investment incentive analysis are also arranged in the section of investor types, since different investors are showing different characteristics. Then I addressed the key issues and trends in this space, including tax issues, granularity, real estate technology investments, macro political trends, the controversial aggressiveness and opportunities for managed accounts business and new players in the field, in order to provide forward-looking perspectives.

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Acknowledgements

During the drafting process of my thesis, I have held multiple discussions with my thesis advisor, program professors, MIT Center for Real Estate alumni, industry professionals in my career network, and my classmates. They have greatly contributed to this thesis with their respective knowledge and views and helped me think over new perspectives. They also introduced valuable reading materials for my reference which helped fulfill the need for data points. With their assistance and advice, I have learned and accomplished a great deal through preparing this thesis.

My sincere gratitude goes to my advisor Dr. Albert Saiz, especially for his patience, guidance and detailed comments on this thesis. He also granted me great flexibility to think and explore in different ways.

Additionally, I would like to thank others that made this study possible by sharing their insight, knowledge and inspiring vision with me, including professionals from the fields of investments and acquisitions, fund management, development, investor relations, insurers, brokerage, commercial and investment banking, legal and tax advisory, market research, industry associations, constructors and corporates. The meetings and discussions I had with these industry experts provided sights and angles that helped frame and support this thesis.

Last but not least, I would like to specially thank the MIT Center for Real Estate alumni for spending their valuable time to share with me their views. Many of them are at senior management levels of their respective platforms yet kindly accepted my invitation for interview without hesitation. They also offered great help in terms of introducing their colleagues or insider data sources which I could not have reached out to on my own, especially at earlier stage of my interview process. They are the strongest support of the MIT real estate network.

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I - Introduction

With a record-breaking total investment value of US\$9 billion in 2015 and cumulative US\$17 billion since 2010, as well as multiple billion-dollar-size headline transactions, Chinese capital has drawn wide attention in the U.S. commercial real estate market, sometimes surprising the U.S. counterparties with their aggressiveness, ample investment flexibility and pursuant for partnerships. This wave of Chinese investment also comes from a highly diversified pool of institutions, including developers, insurers, private equity funds, mutual funds, investment agencies and advisors, commercial banks, Sovereign Wealth Funds, State-owned-enterprise, private investment conglomerates, construction companies and large corporates, each with their own incentives and considerations. Even the largest U.S. databases tracking these deals admitted that they only managed to capture the majority part of this highly dynamic space and there must be some transactions left out or not disclosed sufficiently in public. The estimated total institutional investment deal value has exceeded US\$10 billion. At the same time, these Chinese investors are constantly making adjustments in their investment structures and asset selection strategies, and try to follow the market as close as possible so they could make timely yet sound decisions, not only from a return-and-yield perspective, but also to satisfy their goals of asset allocation, market expansion, currency management, product learning and relationship management.

The Chinese outbound capital in U.S. real estate is in fact a well-covered subject in mass media and I have come across numerous news articles and research reports written on these deals. However, they hardly provide truly analytical judgements, and raised my interest to conduct a systematic study by myself. Having worked in Asia real estate investment advisory space for a few years covering the China side of these institutions, and then a short period of time in the outbound investment team of a Chinese institutional investor looking to allocate capital in developed economies, I had the privilege to look at these players and deals from a relatively insider angle, and meet various professionals active in this space. Through interacting with parties involved in these deals, I come to realize that data and deal terms are only part of the picture, and so much more information lies in the stories behind, which could be conveyed through case studies combining inputs from both China and U.S. sides, and interviews on an anonymous basis, which would be the main approach of my thesis. I also aim to identify some key issues, trends and opportunities, although without any numerical projections.

II – Background

i. China Overview

China, officially the People's Republic of China (PRC), is the world's most populous country with a population of over 1.38 billion and also has the world's second largest GDP of US\$10,983 billion for the year of 2015. Since the introduction of economic reforms in 1978, China has become one of the world's fastest-growing major economies as well as the world's largest exporter and second-largest importer of goods. Being a member of numerous formal and informal multilateral organizations, including the WTO, APEC, BRICS, the Shanghai Cooperation Organization (SCO), the BCIM and the G-20, China is increasingly considered as one of the most influential power nation for the rest of the world.

Although there is emerging concern internationally about slow-down or potential economic collapse in China, the country's economic growth has proved to be resilient so far with 6.9% GDP growth rate in 2015. While slower than previous years, this is still among the highest of the world's major economies, and given the size of China's economy today, the increase in economy output in 2015 was still higher than in previous years when the growth rates were higher. According to forecasts by the International Monetary Fund, China is expected to continue being the largest contributor to world GDP – in purchasing power parity terms – and is expected to account for nearly 20% of world GDP by 2020, compared to 15.5% for the European Union and 14.9% for the U.S.

Nevertheless, despite the tremendous size, the continuous growth rates and the potential to be super power of the world, China is also faced with multiple challenges, including overcapacity and over-construction in industrial and infrastructure sectors, accumulated national debt, lackluster export dragged down by global demand and insufficient financial market legislations, and correspondingly steps in the process of transitioning from an investment-intensive, export-led model of growth to a high value-added consumption- and innovation-driven one. According to China's National Bureau of Statistics, by the end of 2015, the tertiary industry accounted for 50.5% of national GDP, exceeding 50% for the first time of past ten years.

The Chinese government also implemented a series of national policies and encouraged municipal policies to facilitate the transformation process. On 29 October 2015, at the Fifth Plenary Session of the 18th Communist Party of China (CPC) Central Committee, the leadership of the Party adopted the CPC Central Committee's Proposal on Formulating the Thirteenth Five-Year Plan (2016-2020) on National Economic and Social Development, which targets achieving a “moderately well-off” society, emphasizing the five underlying concepts for the country's development over the period from 2016 to 2020, namely “Innovation”, “Regional development”, “Green development”, “Opening up” and “Inclusive development”. In order to further boost consumption growth and urbanization, the Chinese government has stated that it intends to increase the

percentage of the population in urban centers to 60% by the end of 2020 by issuing 100 million urban hukous, developing more city clusters and implementing “Belt and Road” initiative to contribute to the development of China’s landlocked western provinces and improve regional infrastructure connectivity. The economic transition and supporting government policies also have profound implications in the context of Chinese outbound investments, which we will further discuss in later chapters. However, the significance of these “13th Five Year Plan” policies depended on follow-up laws and regulations that are fully clarified and enforce.

ii. Chinese Outbound Investments Overview

In 2015, Chinese Outward Direct Investment (“ODI”) flows increased by 14.7% to reach a historic high of US\$118 billion, at a CAGR of 23.5% from 2006 to 2015. In terms of sector and geographic breakdowns of ODI, according to the most recent National Bureau of Statistics data which is as of 2014, we could see the tertiary industry generated majority of the growth. Exhibit 1 shows the detailed sector rankings of China’s outbound M&A deals in 2015. The sectors with highest 2014 YoY growth rates are health, social security and social welfare (801% and 2010-2014 CAGR of 189%), management of water conservancy, environment public facilities (281% and 2010-2014 CAGR of 29%) and hotels and catering services (198% and 2010-2014 CAGR of 28%). Real estate showed resilient YoY growth rate of 67% and 2010-2014 CAGR of 50%, ranking the 5th in terms of disclosed deal value (US\$7.4 billion) and the 3rd in terms of number of deals (35 deals). In terms of geographic destinations, the top 10 countries include a combination of both developed economies and emerging markets, with the U.S., Luxembourg (as the world’s second largest fund center and long-established fund domicile for investment flows out of China), Australia, Singapore and the U.K. ranking as the top five destinations both in terms of flows and stock. Within the top 10 destinations, the five countries with the highest 2011-2014 CAGRs were the U.K., the U.S., Indonesia, Kazakhstan and Russia.

Exhibit 1: Top 10 Sectors for Chinese Outbound M&A Deals in 2015, by Value and Number of Deals

Rank	Sector	Disclosed value (US\$ billion)	Sector	Number of deals
1	Financial services (including insurance)	18.1	Computers and electronics	99
2	Computers and electronics	11.8	Healthcare	54
3	Utility and energy	10.2	Real estate (including hotels and restaurants)	35
4	Automobile	9.6	Mining	33
5	Real estate (including hotels and restaurants)	7.4	Financial services (including insurance)	27

6	Transportation	7	Transportation	26
7	Oil and gas	6.8	Utility and energy	23
8	Mining	4.5	Professional services	24
9	Healthcare	3.3	Consumer products	23
10	Leisure and recreation	2.2	Oil and gas	21

Source: KPMG China Outlook 2016

Chinese companies conducted 502 outbound M&A deals in 2015 totaling deal value of US\$88 billion, and another US\$75 billion of deals announced in 2016Q1. Major recent deals announced include China National Chemical Corporation's US\$43 billion acquisition of the Swiss agrochemical and seeds company Syngenta, Hainan Airline's US\$6 billion acquisition of Ingram Micro (a U.S.-based company specializing in the provision of global supply chain and technology solutions), Haier's US\$5.4 billion acquisition of General Electric's Appliances business, Wanda's US\$3.5 billion acquisition of U.S. film studio company Legendary Entertainment and Ningbo Joyson Electronic's US\$920 million acquisition of Key Safety Systems (a U.S.-based global supplier of advanced engineered safety products for automotive and non-automotive markets).

Comparing the recent deal sheet to a few years ago, we could see a clear focus on high value-added and consumption / technology-related sectors, especially in the computers and electronics sector. In particular, China's investment targets in the U.S. increasingly emphasize sectors such as computers and electronics, healthcare, real estate, telecoms and insurance, with continuous initiatives on machinery, utility and energy sectors. On the other hand, in terms of acquirers, we see emergence of privately-owned companies, especially domestic industry leaders, who enjoy the benefit of supporting government policies, available low-cost acquisition financing and competitive advantages in consumption-related industries. In 2015, private companies announced deal value of US\$34.9 billion, a huge jump from merely US\$4.6 billion in 2010.

Apart from traditional corporate-level acquisitions, financial investors are also becoming active in the Chinese ODI landscape, including: (i) insurance companies driven by policy relaxations by the China Insurance Regulatory Commission ("CIRC") and higher return requirements; (ii) state-owned financial institutions / funds / multilateral development banks supporting corporate acquisition moves; (iii) Chinese private equity funds responding to LP's needs for overseas asset allocation and; (iv) Chinese-backed venture capital firms looking for opportunities outside China to strengthen their offerings in the domestic market. This trend is also seen widely in the real estate sector, as we will discuss in detail in later sections.

The drivers of this wave of outbound capital flow include partnership and corporation, business diversification, asset allocation, currency risk hedging for weaker RMB, and slowing down domestic economy. In the mind of

traditional Chinese business philosophy, the best way to partner is through capital, or the “hard power”, to bring both parties to the relatively equal level of negotiation. The Chinese government also joined force to push wider expansion of Chinese outbound investments, led by President Xi Jinping's widely-reported “going global” strategy. China’s Premier Li Keqiang also commented in February 2016 that China expects to deploy US\$1 trillion of offshore direct investments over the next five years globally, which would boost annual outflows to an average of US\$200 billion per year, making China the second largest exporter of foreign direct investment behind the U.S.

Under the guideline of “going global” strategy, in September 2014, China’s Ministry of Commerce (MOFCOM) released the revised Administrative Measures for Overseas Investment, effective in October the same year. This development followed a November 2013 decision to reform the regulatory approval process in order to promote greater outbound investment. Under these regulations, the approval system for investment projects worth over a specified amount has been eliminated and a registration and filing system has been established for all overseas investment projects, except for some sensitive projects, and the timing for approval has been shortened, implying the government is pushing for simplified administrative process for overseas investments. The release of these administrative procedures has greatly improved the efficiency of Chinese outbound investments. For example, the closing of first U.S. investment made by Vanke to 201 Folsom Street back in 2013 was partially impacted by the process of Vanke obtaining regulatory approval in order to route its US\$175 million funding to overseas. Having a simplified process decreases opportunity cost of capital and strengthens confidence on transaction closing.

Significant regulatory overhaul eased restraints on Chinese capital seeking stronger returns in overseas markets. In 2013, China’s National Development and Reform Commission increased the overseas investment approval limit from \$100 million to \$1 billion, which allowed companies to make investments under \$1 billion without needing prior government consent. Then in 2014, the Ministry of Commerce further loosened restrictions on foreign investment by eliminating prior approval requirements for the majority of outbound investments. These two landmark changes marked substantial steps in China’s outbound expansion, which combines incentives and regulatory overhaul to encourage firms to be global in their outlook and ambitions. The total size of outbound investment jumped from \$600 million in 2009 to over \$10 billion in 2014.

iii. China Real Estate Outbound Investments – Global

China’s outbound investments in real estate sector are driven by a combination of factors, including yield seeking, asset allocation and opportunities synchronized with the outbound activities of other industries such as consumer, trade flows, tourism and education. Among the \$7.4 billion of real estate acquisitions by Chinese companies in 2015, financial investors stepped up in the commercial real estate space taking two-thirds of all the announced deals and 85% of total disclosed value, while developers started to undertake greenfield

investments acquiring plots of land in different countries for further development and higher return compared to mature assets.

A few years ago Chinese developers started to look into emerging markets such as India and Southeast Asia, when it was commonly believed emerging markets generated higher-than-average return. They soon realized, together with financial investors who have been funding or partnering with these developers, that investments risked high failure rate in emerging economies and that mature markets represented the safest opportunities, such as commercial real estate in global gateway cities, before they accumulated sufficient local knowledge and expertise and got ready to push outward into less developed markets.

Although U.S. is one of the top destinations for Chinese outbound capital interested in commercial real estate, it is among many other cities worldwide that also offer attractive investment opportunities, sometimes with less stringent regulatory requirements for development practices and less yield compression. However U.S. cities have been taking a larger share during the past five years. Exhibit 2 lists the top 10 cities for Chinese outbound commercial real estate investments in last five years and 2016 YTD. The legal transparency, well-established property ownership and relatively stable financing environment have made U.S. an unparalleled investment destination. The U.S. market is also much deeper than many other developed economies where a few gateway cities dominate the spectrum of acquisition opportunities. According to Chinese institutional investors who already have track record and experience in the U.S. market, there are attractive opportunities in secondary markets and even tertiary markets as long as they are in position to conduct sufficient due diligence exercise.

Exhibit 2: Top 10 Global Markets for Chinese Investment in Commercial Real Estate

2011-2015 in Total		
City	Number of Properties Invested	Deal Value (\$million)
Manhattan	47	10,701
London	31	9,556
Sydney	133	7,306
Hong Kong Island	33	4,681
Singapore	31	4,348
Kowloon	18	2,902
Chicago	53	2,521
Johor Bahru	4	2,371
Melbourne	119	2,323
Others	1,505	41,322
2016 YTD (till March 31, 2016)		
City	Number of Properties Invested	Deal Value (\$million)
Hong Kong Island	3	2,918
Manhattan	12	2,107
Chicago	3	1,605
San Francisco	2	1,265
London	4	1,264
Orange County	2	695
San Diego	1	690
San Jose	5	536
Los Angeles	4	531
Others	45	3,235

Source: Real Capital Analytics

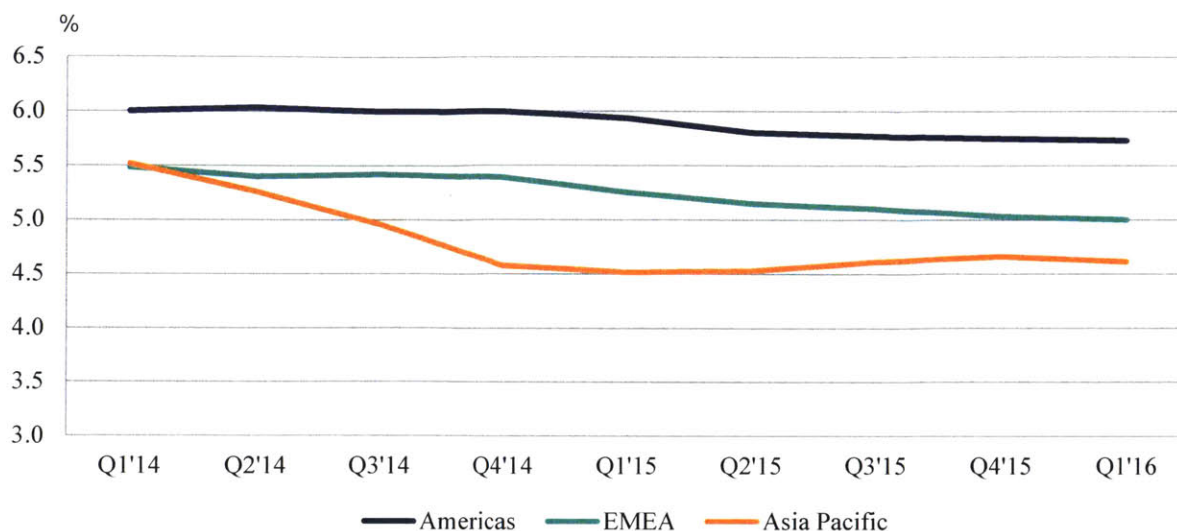
Exhibit 3 shows the various transaction yields of top destination cities for international capital, and we could see the investment yields of real estate in U.S. metropolitan markets are within the range of global gateway cities, despite the multiple headlines reporting international buyers are purchasing NYC properties at absurd pricing levels. According to Exhibit 4, the average transaction yield in of top 25% assets in the Americas has not been compressed as in EMEA and Asia Pacific. Although the top assets in the U.S. are not as richly priced as some investors may have expected, it still raised eye brows to see certain deals executed by Chinese buyers at 3% or 4% cap rates, and we will further analyze their incentives and deal dynamics in later sections.

Exhibit 3: Investment Yields of Global Gateway Cities (2016Q1)

Market/Segment	Average Yield / Cap Rate	QOQ Chg (BPS)	YOY Chg (BPS)
London Metro	4.6%	-2	-37
Paris	5.5%	-21	-48
Other Tier 1 Metros	5.5%	-15	-60
German A Cities	6.5%	-1	18
UK Big 6	6.9%	-15	-6
UK Mid 10 Cities	7.3%	-16	-8
EMEA Average	6.0%	-12	-23
NYC Metro	5.5%	-7	7
LA Metro	5.7%	-9	-38
SF Metro	5.8%	-3	-2
United States	6.5%	-3	-20
Canada	5.2%	-45	-100
Latin America	8.6%	-7	35
US 6 Major Metros	5.8%	-6	-15
US Non Major Metros	6.8%	-3	-26
Americas Average	6.5%	-4	-20
Tokyo	4.8%	-6	5
Hong Kong	2.9%	5	20
Melbourne	5.9%	-22	-92
Sydney	6.8%	-11	-38
Osaka	5.0%	-22	-43
Asia Pacific Average	5.9%	-9	-1

Source: Real Capital Analytics

Exhibit 4: Yield Trends for Top 25% of Assets



Source: Real Capital Analytics

Europe is seen as a key substitute market of the U.S. given the similarities in terms of economic development, market maturity, legal framework and rules and regulations. Chinese outbound direct investment in Europe has grown exponentially in recent years and hit a new record high of EUR 20 billion (US\$23 billion) in the year of 2015, illustrating China's potential to become an important source of capital for Europe and triggering an ongoing competition among EU states for Chinese capital. Approximately 35% of total transactions were generated in the real estate lodging sector, including acquisitions of Louvre Hotels and Club Med. The "Big Three" economies, namely Germany, the UK, and France, are considered top destinations for high-quality safe-haven assets, while other countries, especially those in Southern Europe, provide attractive investment yields. At the same time, Europe is in deeper need for capital compared to the U.S., after a decade of economic slow-down and sluggish domestic capital flows. Current monetary policy and negative interest rate implemented by the European Central Bank has flooded the market with low-cost capital, which is deemed unsustainable and may require foreign investments to mitigate the liquidity risk once monetary policy changes.

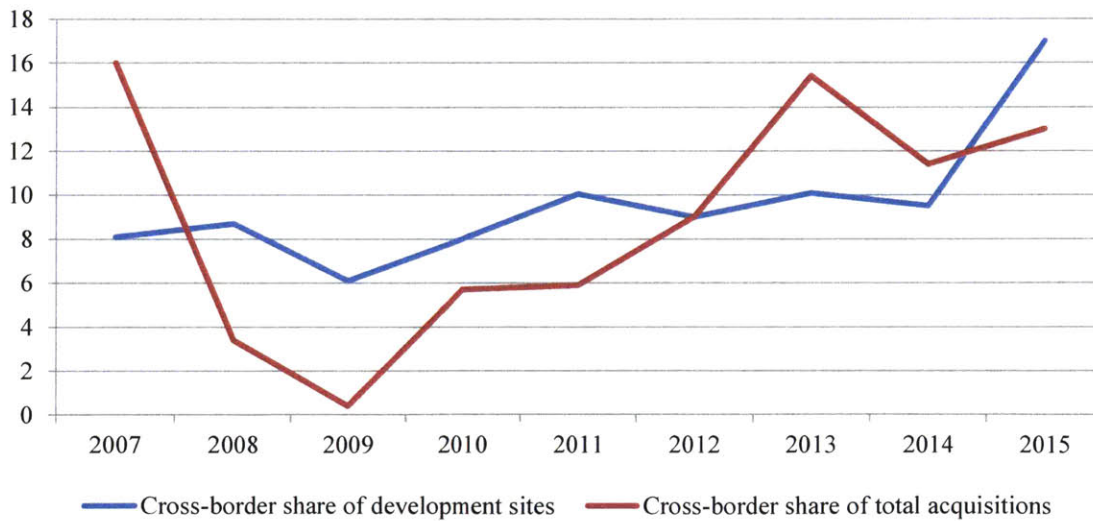
iv. International Capital in U.S. Real Estate

The U.S. property market is attractive to foreign investors for a number of reasons. The U.S. is one of the few countries in the world that are friendly to foreign investors in general, both historically and now, and the threat of government expropriation is virtually nonexistent. Despite recent controversies spurred during the presidential election, the U.S. government and major U.S. institutions recognize the tax contributions, market promotions and offsetting of trade deficit provided by international capital inflows. The U.S. economy and

financing environment is also stable and systematic, and offers a broad investment landscape, including opportunities in virtually any type of real estate. Most foreign investors believe in the sustained growth of the U.S. economy in the long run, which will translate to real estate market and asset pricing, as well as relatively low cap rates at asset exits. Also, the ease of entry into the U.S. real estate market with a wide array of financing alternatives provides an incentive for foreign investors. Moreover, the U.S. has a ready supply of relatively inexpensive yet high quality land, except for top-tier urban markets such as Manhattan. Land parcels with favorable conditions and infrastructure support are widely supplied across the country, compared to many other countries where the geographic environment is not as advantageous. Lastly, many foreign investors are capitalizing on the value appreciation of the American lifestyle, where people from worldwide are trying to seek residence and career.

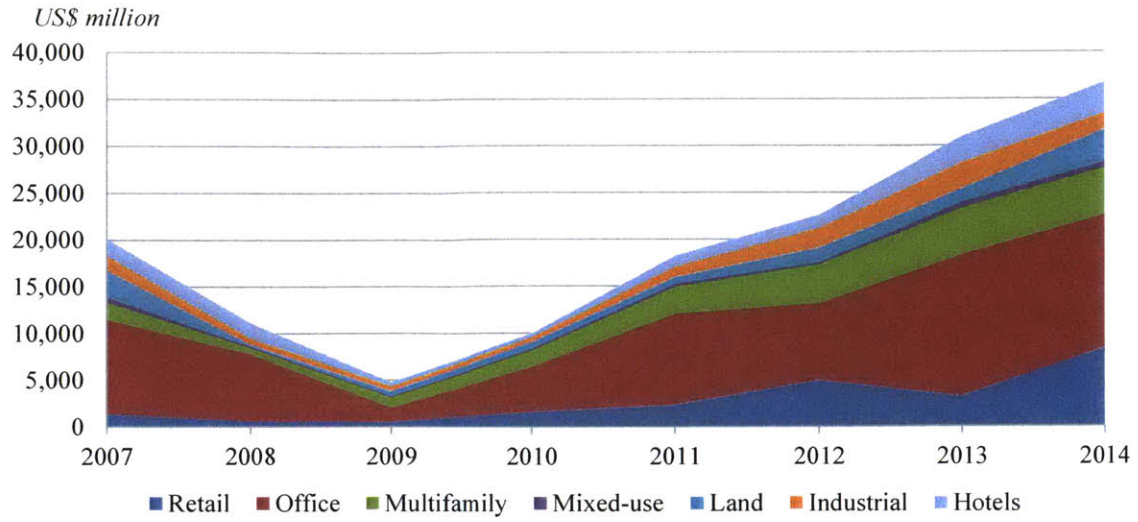
Exhibits 5 show the share of cross-border capital in the U.S. market from 2007 till 2016Q1, and Exhibit 6 breaks down into different property types and shows trends for each property type, with data available till 2015. We can see the trend of increasing share of development sites where international investors are willing to take development risk and work more closely with local partners to secure good locations at earlier stage, and also trends of growth across all property types beyond the traditional core office properties in gateway cities.

Exhibit 5 – Cross-border Shares of U.S. Real Estate Transactions



Source: Real Capital Analytics

Exhibit 6 – Cross-border Investment in U.S. Real Estate by Property Types



Source: CoStar Portfolio Strategy

Part III – Analysis of Chinese Outbound Investments in U.S. Real Estate Market

i. Size update

According to data tracked by Real Capital Analytics, in 2016 up to date, Chinese investments in the U.S. recorded 47 transactions with total deal value of US\$9.3 billion. These are publicly disclosed asset / portfolio investments by institutional investors, and have excluded investments made by individual investors and equity purchase in secondary markets such as investments in REITs.

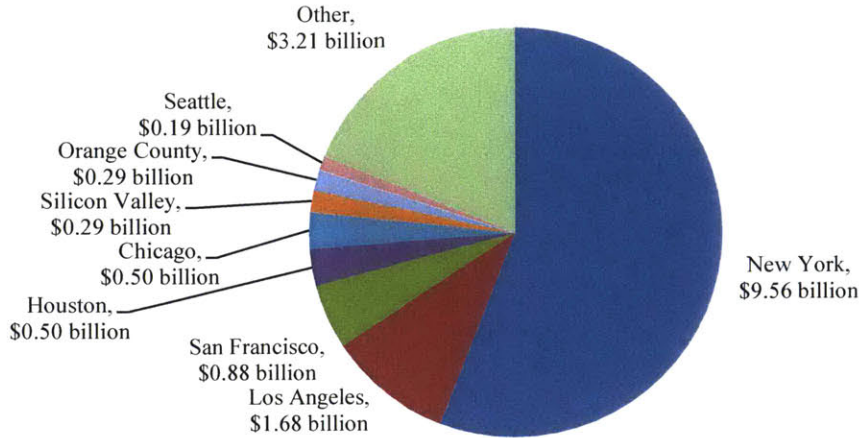
ii. Structures

The Chinese capital has entered the U.S. real estate space through multiple structures: (i) acquisition of existing commercial and residential properties; (ii) development activity; (iii) investment in portfolios of U.S. assets through REITs and private equity funds; (iv) financing of development projects through an investor visa program (EB-5); (v) lending by Chinese banks; (vi) holding of U.S. agency-backed securitized debt vehicles. Combining all these types of real estate investments, China was the source of approximately \$350 billion in U.S. real estate investments, both direct and indirect, by the end of 2015, as estimated by Rosen Consulting Group in a study jointly published with Asia Real Estate Society.

iii. Geographic breakdown

Exhibit 7 shows the geographic breakdown of Chinese commercial real estate acquisitions for the period of 2010 to 2015. This ranking is generally in line with the market heatedness and U.S. domestic capital inflow into these cities, although partially impacted by Chinese immigration and tourism trends. Their risk preference for these markets is also largely in line with their peer U.S. institutional investors. One note-worthy point is that Chinese investors only committed to development projects in approximately 20 primary markets, compared with more than 40 primary and secondary markets for acquisitions of mature assets, implying their diligent assessment of development risk.

Exhibit 7: Chinese Commercial Real Estate Acquisition Volume By Metro Area, 2010-2015

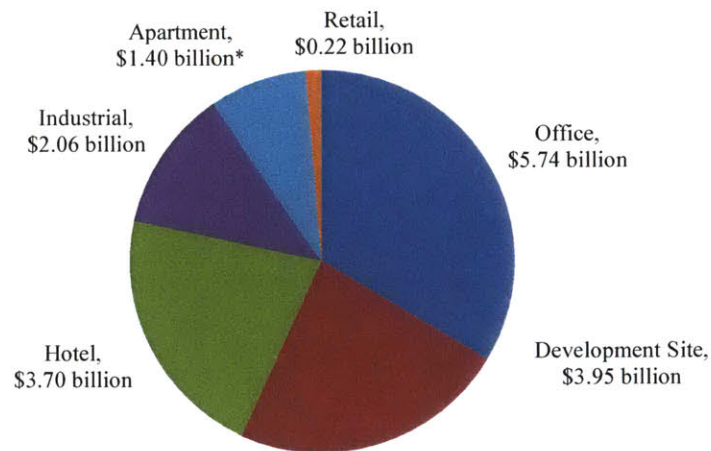


Source: Real Capital Analytics

iv. Property type breakdown

Exhibit 8 shows the property type breakdown for Chinese capital acquisitions of U.S. commercial real estate assets for the period of 2010 to 2015, where a few gigantic transactions in office, hotel and industrial sectors noticeably boosted shares of these sectors. To obtain a clearer picture, we interviewed some Chinese institutional investors about various property types and their views and preferences are summarized below:

Exhibit 8: Chinese Commercial Real Estate Acquisition Volume By Property Type, 2010-2015



Note: *Rapid growth in 2015 but historically lower than other property types
Source: Real Capital Analytics

- Industrial*: Investors appreciate the relatively affordable cap rates of 6-7%, the long lease term, limited over-supply risk compared to other property types, and the downside protection afforded by the triple-net leases in typical sale-and-lease back deals. The locations of some target assets at suburb circles of gateway cities tend to make an attractive investment story for Chinese investment committees. Another easy-to-market point is multiple demand sources from various industries including technology, consumer, lifestyle / urban living, logistics and e-commerce. Investors also recognize the booming trend of the industrial property sector in China, and that the asset and logistics management technologies in the U.S. market can be transferred back to less developed domestic sector, where they also plan to develop or invest in. Moreover, industrial assets have relatively simple construction and maintenance processes, and generally require less due diligence and asset selection efforts, as long as the location is right, which is partially why some investors are actively searching for investable large portfolio of assets, for the efficiency of capital deployment. Last but not least, some investors are seeking to partner with Chinese conglomerates who have expanded or plan to expand into U.S. manufacturing space.
- Residential*: Investors split between mid-to-high end single family home sales / rental targeting wealthy Chinese immigrants, and fast-growing sector of multifamily apartments generating attractive cash flows and investment returns. The former provides an attractive option for capital parking as well as a product type feathering villa-style living experience, which lacks supply of high quality products in China and will continue to generate demand among the growing Chinese middle class, subject to any upcoming trends in immigration policies. The latter is seen as a trendy asset allocation option and addresses the popularity of urban living in downtown clusters, or urbanization, which is also a welcomed investment theme in the Chinese residential market. Apartments also offer profitable use and development options for urban infill land parcels and cater to Chinese investors who are eager to take market share in metropolitan areas of gateway cities. For example, a New York-based firm that intermediates cross-border investment has been doing ground-up apartment development in spots like Altamont Springs outside Orlando, Revere near Boston, and the Clayton suburb near St. Louis, and sees these as urban infill locations. However, both asset classes are facing the issue of potential over-supply and over-pricing at tight cap rates, which have raised concerns across investment committees of some Chinese institutions but remain attractive to look at. There are also investors considering the luxury serviced apartment option which combines certain advantages of both asset types. Affordable housing, although a heated subsector in the U.S., has not raised much interest among quality-driven Chinese investors.
- Office*: Chinese investors are balancing their focus between mainstream Class A assets which they have been investing for years and rapidly growing Class B assets at top-tier locations supported by branded development and operation partner. Among 2015 office sector investments, 80.0% are acquisitions of trophy or Class A assets while 20.0% turned to Class B, compared to merely 6.7% allocated to Class B in 2014. In terms of deal value, this equates to US\$4.1 billion of Class B acquisitions in 2015, up from

US\$645 million the prior year. New York has shown the greatest increase in Class B diversification, at a multiple of 8 times to US\$1.7 billion, with Class B investments in Chelsea, Grand Central and Columbus Circle. However, the diversification activities are not as evident outside of New York, and cross-border capital still focus on prime markets. They also prefer product types catering to multi-sector large corporate tenants and ideally existing portfolio of long term leases, instead of niche subsectors such as micro-building office and start-up space, as they are not certain about the cyclical trends of various industries in the U.S. The most successful office property cases in China are commonly located in downtown commercial clusters and feather retail and dining service elements, and Chinese investors would appreciate similar characteristics for their investment targets in the U.S. If the ideal assets are richly priced at compressed cap rates, Chinese investors would put a longer term view on the potential deal and enjoy the steady rental cash flow during the investment period.

- *Hotels*: Hotel is seen as an operating cash flow business and provides the opportunity to partner with international hotel managers and play the passive investor role for Chinese investors. It is not as aggressively priced or over supplied compared to office and multi-family, and offers a sizable portfolio of high-quality assets at key locations of gateway cities, with almost-guaranteed good operating performance and asset value. Although the overall hospitality industry is cyclical, it is much less so for these assets, especially when there is a theme attached with the investment story, such as next to Time Square, at coastal California or next to Disneyland. On the other hand, international investors are diversifying from full-service hotels and increasingly looking at limited-service hotels, in sync with their view on the U.S. tourism industry where middle-class and millennial travelers keep dominating.
- *Retail*: Chinese investors focus on Class A shopping centers, ideally with certain tenants in the luxury goods category, or urban product with strong U.S. sponsors, which they call “branded” properties. The investment sentiment in retail is partially negatively impacted by severe over-supply of mixed-use large-scale shopping centers in China, which some developers and investors are still struggling to divest. They also have concerns about tenant mix management and leasing strategies given their limited knowledge of U.S. consumption habits and brand trends. Some of the top quality assets in the U.S., according to some investors, are already held by a few national retail REITs instead of institutions. For investors able to successfully aggregate urban scale in leading U.S. markets, opportunities exist for co-investment with larger cross-border investor groups. However, urban high street appears as an attractive investment option. The wealthy shoppers appear less disrupted by online retail and appreciate the fancy shopping environments and services. Spots supporting high-rise multifamily development and investment, such as South Lake Union in Seattle and Bunker Hill in Los Angeles, provide opportunity to feather walkable, amenity-laden neighborhoods that support high street retailing.
- *Niche products*: According to Ernest & Young Real Estate Acquisitions Advisory, Chinese investors are literally looking to all property types available in the market, ranging from traditional property types to

emerging property types such as resorts, warehouses, ports, senior housing, student housing, concept stores and micro living, which may deliver more attractive yields, cater to a growing niche market and have the themes and uses with huge potential in the Chinese market as well. By investing in these specialized spaces, Chinese developers and private equity funds can transfer the development experience back to their domestic market. The pre-condition of investing in these niche products has always been a strong operating partner, as most of these assets require hands-on management and Chinese investors are seeking operating know-hows and potential partnership opportunities in China besides financial returns.

- *Development sites*: Although not an independent asset class, development sites are showing increasing popularity among Chinese investors and we would like to discuss in some further detail. The growing share of development sites highlight the trend of Chinese developers and institutional investors utilizing investment strategies such as building-to-core in order to deliver return in a market of high asset pricing for core properties and also to play with industry cycles, expecting another upward trend in next few years. In fact, the number of development site acquisitions (68 deals) exceeds all other property types, followed by office (43 deals) and hotel (32 deals) for the period of 2010-2015, with great potential for future asset value appreciation. Development activity is skewed largely to residential projects, primarily condos. More than 30 of the identified development projects are exclusively residential (save for small, ground floor-only retail components), while nearly 20 more are mixed-use with significant residential components. Among mixed-use projects, 11 have retail components, while 8 will feature a hotel and 5 will feature office space. There are only a handful of office-only projects, two industrial projects, and one hotel-only project.

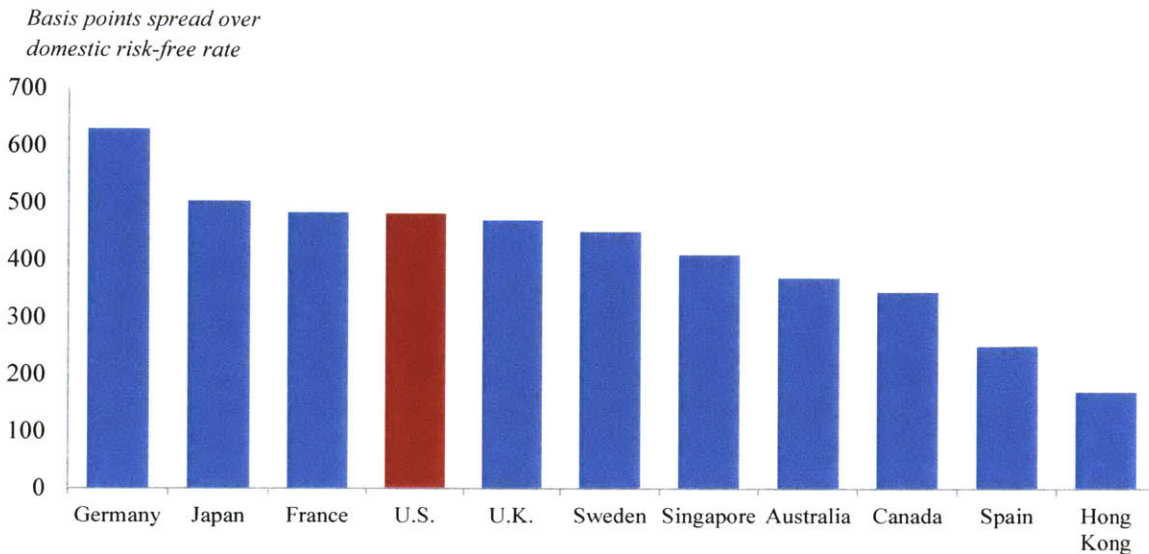
Part IV – Analysis and Case Studies of Key Investor Types

i. Sovereign wealth funds (“SWF”)

SWFs are one of the early participants of outbound investments in the real estate space, both in China and across the world. According to 2015 Preqin Sovereign Wealth Fund Review, by the end of 2015, 55% of global SWFs allocated over 5% of funds available to real estate assets, while over 99% of all SWFs are targeting over 5% allocation to real estate, with over 40% of these SWFs targeting over 10%, implying considerable potential for these sovereign funds to further increase their allocation to real estate. For the SWFs that already invested in real estate, 86% are allocating to direct investments, 64% to private investments and 32% to listed investments. In terms of strategies, 75% invested in value-add, 71% invested in opportunistic, 61% invested in distressed and 57% invested in core. Secondaries and fund of funds vehicles are the least favored strategy for SWFs, as the level of sophistication and capital potential of these investors typically enable them to access the asset class through primary fund commitments rather than secondary structures. Preqin research also shows that larger funds with the capabilities and expertise to run a globally diversified portfolio tend to show a greater preference and larger asset allocation percentage to real estate, implying that as SWFs grow in size, they will also grow a more sizable appetite for real assets. In China, the three largest SWFs and also the only three cross-border investors so far are China Investment Corporation (CIC), SAFE Investment Company (SAFE) and the National Social Security Fund (NSSF), which are the third-, fourth-, and ninth-largest SWFs in the world, respectively, with approximately US\$1.5 trillion in combined assets as of 2015. CIC and SAFE are equipped with the country’s considerable foreign exchange reserves, while NSSF source funding from the fiscal allocation from the central government, the transfer of state-owned capital and investment proceeds.

Drivers: SWFs are a major group of capital allocators rather than asset managers, so they emphasize depth of asset market, stability of asset pricing, investment yield, availability of partnership structure where they could work with management or investment partners and transparency of property ownership. So far the U.S. market offers a satisfactory combination of all these considerations. Although the Chinese SWFs may be under government mandate to conduct asset allocation on global scale, they will continue to allocate a sizable proportion to the U.S. In terms of investment yield, U.S. still offers relatively large spread over domestic risk-free rate according to Real Capital Analytics data shown in Exhibit 9. As the Chinese SWFs are able to achieve market-rate debt financing in their deals, the U.S. market offers an attractive investment option, while SWFs can choose between lower-yield lower-risk assets in gateway cities and less expensive assets in secondary markets. The question of whether these investors are over-paying in certain deals will be addressed in the section of “The Controversial Aggressiveness”.

Exhibit 9 – 1Q2016 Spread over Domestic Risk-free Rate



Source: Real Capital Analytics

Case Study: CIC. CIC was established in 2007 as a wholly state-owned company with the core mission of managing part of China’s foreign exchange reserves, modeled according to Temasek Holdings of Singapore. CIC has been the most active cross-border real estate SWF investor and invests in the global market through various structures, including Joint Venture (acquisition of AMA Plaza in Chicago with LaSalle), direct acquisition (purchase of 10 malls in France and Belgium with asset management partner; purchase of Investa Property Group’s Australian office portfolio with Investa retaining management), refinancing (purchase of preferred equity stake to refinance a Manhattan office tower co-owned by Carlyle Group), stock purchase (acquisition of 7.6% stake in General Growth Properties) and secondaries (bidding for Harvard Endowment Fund’s portfolio of stakes in various U.S. funds). CIC also stands behind the two major Chinese lenders active in the U.S. market, holding 35% of Industrial and Commercial Bank of China and 64% of Bank of China.

Although CIC started to look into the U.S. market over a decade ago, it was focusing on general financial investment in the beginning and got burned by the losses occurred with its investment in Blackstone in 2007, right before the Global Financial Crisis. CIC then cautiously laid out its investment scale and worked with professional advisors and investment partners in the local markets. Beginning in early 2016, CIC established a stand-alone real estate division and decided to allocate 10% of its US\$740 billion asset under management to finding prime investments around the globe, a sizable share of which would flow to the U.S. market.

In 2014 (the most recent data point available), CIC's overseas portfolio posted a net annual return of 5.5% and a net cumulative annualized return of 5.7% since its inception. As of 31 December 2014, CIC allocated 44.1% to public equities, 26.2% to long-term investments including real estate, 14.6% to fixed-income securities, 11.5% to absolute return and 3.6% to cash and others. 67.7% of these assets are externally managed such as secondaries, while 32.3% are internally managed such as in-house fundamental analysis.

Case Study: SAFE. SAFE was established in 1978 with the administrative task of drafting rules and regulations governing foreign exchange market activities, and managing the state foreign exchange reserves, which to some degree overlaps with CIC's mission. According to news analysis, with the burgeoning of China's reserves and amidst increasing rivalry between state agencies, there are signs of growing independence of and competition between CIC and SAFE. SAFE has four overseas investment platforms with separate offices in Hong Kong, Singapore, London and New York. Unlike CIC's high profile news reports and open communication with public, there is very limited public disclosure in regard to SAFE's investment scale and portfolio companies, possibly as SAFE's role of foreign exchange policy making. As of 2014, SAFE Investment Company had asset under management of approximately US\$600 million, according to a report published by Sovereign Wealth Fund Institute.

Case Study: NSSF. NSSF was established in 2000 as one of the central government's measures to serve as a solution to the problem of aging population and provide a strategic reserve fund accumulated by the central government to support future social security expenditures and other social security needs. It is managed by the National Council for Social Security Fund and has set up main investment scope including: (1) domestic investments, such as bank deposits, treasury bonds, financial bonds, corporate bonds, securitized products, securities investment funds, stocks, industrial investments, industrial investment funds and trust investments; (2) overseas investments, such as bank deposits, foreign treasury bonds, bonds of international financial organizations, bonds of foreign entities, foreign corporate bonds, overseas bonds issued by the Chinese government or Chinese enterprises, money market products such as banking drafts and large CDs, stocks, funds, derivative instruments such as swaps and futures, and such other investment products or instruments jointly approved by the Ministry of Treasury and the Ministry of Labor and Social Security. Although NSSF is allowed to invest in stocks and funds, it is so far the only SWF that invests solely in listed real estate, partially due to the general requirement of investing in highly liquid products and NSSF's investment tradition in domestic market. It also indirectly participated in overseas portfolio investment through investing in domestic private equity platforms active in this space, for example, it invested 2% in China Orient Asset Management Corporation, one of the most active portfolio investors in the U.S. market.

In contrast to the majority of Chinese investment agencies which follow a case-by-case reporting approach with a centralized investment committee, NSSF follows strict top-down asset allocation practices for its various investment vehicles, including:

- Stock assets $\leq 40\%$;
- Bank deposits + treasury bonds + policy financial bonds $\geq 40\%$;
- Local governments bonds+ corporate bonds $\leq 20\%$;
- Asset-backed securitized products $\leq 10\%$;
- Direct equity investment $\leq 20\%$;
- Equity investment fund $\leq 10\%$;
- Trust investment $\leq 10\%$; and
- Overseas investment $\leq 20\%$

As of December 31, 2015, the total value of assets under management of NSSF reached US\$293 billion. Among various asset categories, the fixed income assets account for 49.70%, domestic stocks account for 30.14%, overseas stocks account for 8.41%, industrial investments account for 11.72%, cash and equivalent for 0.03%. During 2015, the investment proceeds of assets under management of NSSF were US\$35 billion with a rate of return of 15.19%. By the end of 2015, NSSF had achieved accumulated investment proceeds of US\$121 billion since its establishment, with an annual investment yield of 8.82%.

Case Study: Provincial-level Pension Funds. Unlike NSSF who follows policy statement such as the Interim Measures on the Investment Management of the National Social Security Fund, provincial-level pension funds, or social security funds, operate and invest according to policies of the Ministry of Treasury and the Ministry of Labor and Social Security as well as various local regulations. According to the latest announcement by the Ministry of Treasury, local social security funds are only allowed to invest in domestic bank deposits and treasury bonds, in order to restrict local governments' urge to make aggressive investments. As a result, most local social security funds have been incurring zero or negative real returns. Starting from 2012, certain local social security funds are also allowed to deposit the surplus of their enterprise employee's basic pension insurance to NSSF, which NSSF will include in its fund portfolio and make investment decisions, similar to the trust structure, or General Partner – Limited Partner structure where NSSF is de facto the General Partner. Guangdong Province started depositing to NSSF since 2012 and Shandong Province since 2015. According to Chinese news, more provinces are waiting in line to participate in this structure, leading to a potential US\$90 billion jump in NSSF's asset under management.

ii. Real estate developers

Drivers: The Chinese real estate developers are driven by multiple push and pull factors to expand overseas. In terms of push factors, the Chinese domestic real estate market has been over-heating for a few years as a combined result of local government push and liquidity flooding. Fearing a potential asset bubble, the central government initiated a mix of restrictive measures, making it increasingly difficult for Chinese developers to win domestic land auctions at acceptable cost and get approvals. Turning to offshore market for better

development yields has become a feasible option. There are also benefits of hedging against domestic economy slow-down and currency weakening, and geographic business diversification in a volatile environment. In terms of pull factors, apart from profit and yield, Chinese commercial real estate developers also seek to learn the experience from mature markets, including construction technologies, design concepts, property management, retail leasing strategies and marketing platforms. Although real estate is highly localized, Chinese companies have managed to localize countless international technologies and strategies in the Chinese context. It is widely believed that the traditional residential sales model in the domestic market has reached a bottle-neck, and next-generation Chinese developers would need to pursue product diversification, service offerings and building technologies, similar to what their U.S. counterparts did a few decades ago.

Strategies taken by the Chinese developers include flexible partnership structure, development-investment combo and step-by-step penetration in terms of project size and markets. By undertaking development projects in selected cities and in a smaller scale, these developers can start building their track record and strengthening their position in local markets, putting themselves in a position to capitalize on demand from the local community as well as Chinese immigrants.

Case Study: Vanke. Vanke is the largest homebuilder in China with 2015 contracted sales of US\$41 billion, and also renowned for its modern corporate governance system and westernized management culture. Unlike many other leading developers, Vanke started as a private company and still maintains less than 20% of equity stake held by government-related capital. Back in 2013, Vanke has set Tishman Speyer as its corporate development road sample, and endeavors to learn its asset-light strategy and use of operational and financial leverage. In the same year, Vanke kicked off its overseas business and has rapidly acquired nine projects across the U.S. as of May 2016, including:

- 201 Folsom Street in San Francisco (luxury condominiums; partner with Tishman)
- 610 Lexington in New York (luxury condominiums; partner with RFR Holding and Hines)
- 100 East 53rd Street in New York (luxury condominiums; partner with RFR Holding and Hines; financed by the Industrial and Commercial Bank of China)
- 275 Fourth Avenue in New York (condominiums; partner with Adam America and Slate Property Group)
- 10 Nevins Street in New York (condominiums; partner with Adam America and Slate Property Group)
- 45 Rivington Street in New York (luxury condominiums; partner with Adam America and Slate Property Group)
- 600 Wall in Seattle (apartment tower; partner with Laconia Development)
- Pier 6 in New York (apartment and condominiums; partner with RAL Development and Oliver's Realty)

According to news sources, Vanke has been flexible with project development and management controls and is also keen to work with its U.S. partners on their expansions in the Chinese market, such as Tishman and

Hines. Recognizing the significance of partnership in order to capture market with maximum investment flexibility, it extended investment scope from portfolio to platform, and announced investment in Brightstone Capital Partners, a global real estate investment management platform, together with a team of experienced U.S. investment professionals. Brightstone will have the flexibility to invest across the return spectrum, into a wide range of property types, deal structures and hold periods, and with third-party investors. In contrast to the rapidly growing pipeline of investments, Vanke only has a team of fewer than 15 people based in the U.S., and most members of this team are locally-hired non-Chinese speaking professionals, with only a few Chinese representatives to handle the communication with their corporate headquarter in China.

Case Study: Greenland. Greenland is the third largest home-builder in China with 2015 contracted sales of US\$31 billion. Although Greenland was one of the first groups of Chinese developers entering the U.S. market through its EB-5 programs, it has launched development practices in nine different countries across four continents, including the U.S., the U.K., Canada, Australia, Japan, Korea and Malaysia, totaling investment value of US\$19 billion, among which US\$6 billion is invested in the U.S. Although being the leader in domestic development, Greenland pushes for the asset-light strategy and aims to become an investment conglomerate instead, with three key directions of development, Internet financing and global asset management. The number of Greenland's development and investment partners in the U.S. has reached 60. Its landmark investments include:

- Los Angeles Greenland Center (ground-up mixed-use; no operating partner)
- New York Pacific Park (mixed-use; partner with Forest City Ratner Companies)
- New York Park Lane Hotel (condo redevelopment; partner with Al Waseet; 41% stake acquired in exchange for 459 million convertible preferred shares of listed Greenland Hong Kong)
- Residential developments targeting EB-5 programs

Backed by the Shanghai Municipal Government, Greenland has a reputation of building skyscraper for local governments and mega-scale mixed-use developments, and it has brought this development tradition to its international expansion. Another corporate character that extends to Greenland USA is its rapid decision-making process for sizable investments, which centers around key personnel and decision-makers, most of whom are based in its Shanghai headquarter. Shanghai, on the other hand, is China's oldest trade center and famous for wealthy families who desire a westernized life overseas, laying the foundation of Greenland's investment target on Chinese immigrants. Moreover, its recent ambitious acquisition of 41% stake of the Park Lane Hotel on Central Park South NYC targeting redevelopment into top-notch luxury condos, despite recent pricing pressure on high-end residential in the city, comes partially from its determination to scale up

the investment scope overseas and strengthen its market share in the luxury living segment for wealthy Chinese immigrants, which it deems strategically beneficial to the company's long-term development.

Similar to Vanke, Greenland also extended its investment from portfolio to platform. Part of its deal in the Park Lane Hotel investment is to form a joint US\$8 billion real estate investment fund with the Kuwaiti partner to invest in global top-tier real estate assets, and the platform can allow for maximum investment flexibility and scale up through third party capital.

Case Study: Wanda. Wanda Commercial Real Estate is the largest commercial real estate developer and operator in China, managing over 150 mixed-use properties nation-wide. The commercial real estate department belongs to Wanda Group, which owns diversified businesses of property, hospitality, media and entertainment, tourism, retail operations and sports. As a result, Wanda's international investments synchronize with its global expansions across all these sectors, and emphasize acquisitions in hotel properties, hotel management platforms and mixed-use complexes with luxury residential and retail, recognized by modern Chinese as the necessary element of entertainment and tourism. Its signature real estate acquisitions include:

- Chicago Tower (luxury hotel and residential; partner with Magellan Group)
- New York hotel project (luxury hotel and residential; partner to be confirmed)
- Beverly Hills project (luxury hotel; partner to be confirmed)
- Nation-wide cinema chain AMC Entertainment Holdings

The hotel components, according to Wanda, will be managed by its own Wanda Hotel brand, as an ambitious push to bring Wanda's name to global scale, while its 40 five-star domestic hotels are managed by various international brands, such as Sofitel, Westin, Pullman, Hilton and Sheraton. Wanda's ambition of joining the club of top-tier international hotel brands is also seen in its investments in hospitality projects in London, Madrid and Australia Golden Coast.

Case Study: Specialized Developers. In the Chinese real estate market, large national developers are competing with small-to-medium local specialized developers, who have strong bonding with local government in terms of land acquisitions, financing support from local banks and brand recognition among local communities. Similarly, in the U.S., a group of smaller-scale yet specialized developers are actively acquiring sites and developing partnerships. Examples include:

- Homebuilders catering to Chinese immigrants (Landsea Group, Xinyuan Real Estate)
- Office developers with domestic office development leadership and property management platform and looking to expand portfolio overseas (Gemdale)

- Strategic asset allocators seeing international markets as key portfolio component (Modern Land forming AMG Capital to invest in high-quality urban multifamily developments in high growth cities, Shenzhen Hazens Real Estate acquiring Luxe City Center Hotel in Los Angeles and adjacent parcels for office / condo development)
- Financial asset allocators to capitalize on balance sheet liquidity (Shanghai Yudu Group acquiring the Marriott LAX Airport Hotel in Los Angeles, golf course developer Genzon Group acquiring the former Standard Oil Building in San Francisco)

Most of these developers also have a development portfolio concentrated in one of the major economic regions in China, and they hope to bring the design schemes, construction experience and building technologies they learned overseas to their domestic pipeline, while managing development yields onshore and offshore. Also many of these developers are either public listed or equipped with strong balance sheet, giving them financing buffer for development risk overseas.

Case Study: Kuafu Properties. This is a Chinese development company with no developments in China. Based in New York and co-founded by two Chinese professionals experienced in cross-border real estate service industry, Kuafu develops large-scale master planned projects and mixed-use urban developments in primary markets, one of Chinese investors' favorites. It focuses exclusively on Asian capital, mostly from China, and plays the bridging role between U.S. development expertise and Chinese investors. So far it has a portfolio of four mixed-use projects (backed by one Chinese private equity fund) and one EB-5 project, all in New York. Although it positions itself as developer, Kuafu's projects are either jointly developed with another local U.S. developer, such as Related, Siras Development and Ceruzzi Properties, or directly acquired after development is finished. So Kuafu is more of a development manager or investment manager, coordinating the communication between both sides. This type of development service agencies is expected to emerge as more Chinese investors enter the market lacking sufficient due diligence experience and needing help to understand U.S. development practice. Some agencies are also developing managed account business, similar to some U.S. investment managers, and will make acquisitions backed by a specific Chinese private equity fund or insurer.

iii. Insurance companies

Chinese insurers have traditionally seen real estate investments as one of the key alternative asset classes for their portfolio allocation, and made equity investments in various domestic real estate developers and managers, with the holding stake ranging from 5% up to 30%, sometimes even playing the role of activist investor. For example, in April 2014, Sino Life Insurance and Anbang Insurance spurred a stake war through purchasing shares in a bid to establish control over Gemdale, one of top twenty developers in China. Insurance capital is also active in asset-level investments, mostly in debt and mezzanine financing space, bridging the

funding gap of Chinese developers. Insurance capital, specifically life insurance capital, with low-cost and a long amortization period, is a good match with real estates' stable cash profits and appreciation potential.

Drivers: Similar to SWFs, insurers are also capital allocators, but their internal return requirements may be generally higher than SWFs due to their requirement to distribute liability payments, pushing them up in the risk-return spectrum. At the same time, they emphasize operating cash flows and see mature assets one of their priority options, such as high-end hotels and class A office. Some insurers also have multiple buckets of capital (they call "investment platforms") which they allocate to assets with different risk profiles, while also generating acceptable overall rate of return. For example, the insurance premiums, or direct insurance capital, are typically allocated toward lower-risk investments that can generate stable income, in order to fulfill requirements of CIRC and pay out future claims. They may also have separate balance sheet capital to invest in slightly higher risk projects with higher return, sometimes with a developments spread. In addition, Chinese insurers offering wealth management products to customers typically invest this capital in moderate- to high-risk investments, such as value-add projects, new development, and platform investing that can generate appropriate returns to distribute to customers.

Although most of China's top twenty real estate developers have invested overseas in 2015, only seven of China's top twenty insurers have invested abroad, a slight increase from four insurers in 2014. These six insurers include China Life Insurance, Ping An Insurance, China Taiping, Taikang Life, Anbang Insurance, Sunshine Insurance and Union Life Insurance, while another five insurers publicly expressed interest to invest offshore, including PICC, China Pacific Insurance, New China Life Insurance, Sino Life and Chia Post Life. So far all top ten Chinese insurers (in terms of 2015 premium income) have invested or expressed interest to invest offshore, however they need longer time to conduct internal communication and education due to layered reporting structure, and some of them also choose to wait for another few years and see the exits and performance of investments already made by their peers, and how the central government and CIRC will react accordingly. The reduced availability of trophy assets at acceptable yields in the U.S. market and lack of due diligence experience are also slowing down these insurers. Not all insurers have sufficient overseas-educated personnel or corporate infrastructure in place to partner with foreign developers on opportunistic investments, such as China Life and Ping An Insurance co-investing with Tishman Speyer on Boston Seaport development.

Apart from the top twenty insurers, mid-tier insurers are also reported to be actively looking into the U.S. market. Aquity LLC is a financing advisory firm for Chinese investors in primary markets, and sees mid-tier insurers as one of its main capital raising partners, who are open to invest in single properties instead of a portfolio, but strongly prefer top-tier markets such as greater New York area, Los Angeles, San Francisco and Florida, which Aquity LLC covers.

So far the Chinese insurers have largely focused on equity investments in portfolios, and limited their exposure in debt financing, which they actively participate in the domestic market, while the U.S. insurers have been providing construction financing and takeout financing to U.S. developers for years. According to one interviewee, the capital bucket allocated internally to cross-border acquisitions is mainly for asset allocation in stabilized portfolios, and they would not consider riskier development debt financing yet, which requires intensive due diligence at earlier stage of the project. They may consider syndicate deals, subject to further releasing of domestic regulations and their familiarity with certain local submarkets. After all, providing development financing can help these investors better positioned towards providing the permanent financing on a desired core asset. Domestic cost of financing for insurance capital is generally 7-8% in China, implying a potential return hurdle for their intended cross-border investments.

Regulations: The Chinese insurance industry is a highly regulated play, and so are their overseas investments. Chinese insurers' investment rules were released in late 2012 (see "Temporary Measures for Insurance Asset Overseas Investment") when regulators allowed insurance companies to purchase real estate in 45 different countries, and subsequent reforms enabled insurers to invest up to 30% of their asset in real estate, with 15% of such investment overseas. According to current asset allocation regulations of Chinese insurance industry, Chinese insurers can invest up to 15% of their total assets overseas (see "Notice on strengthening and changing the insurance asset allocation"), however CIRC revealed that by the end of 2014, only 0.8% of Chinese insurers' total assets, or US\$13.4 billion, were allocated to the real estate sector, and it was estimated that only half of this was invested overseas, showing sizable growing potential.

However, the Chinese government also signaled, after Anbang's Starwood bid, that it will not let these acquisitions go unlimited. In April 2016, CIRC released further amended rules for insurance funds' investments, specifying in the first rule that it would strengthen supervision of outbound investments, while the relevant regulations and requirements of Bank of China and SAFE shall also be complied with. CIRC also noted that SAFE has, during the past few months, strengthened its scrutiny and supervision of the foreign exchange settlement and remittance for outbound investments by Chinese companies. As usual, there are no explicit restrictions and regulators will make judgements on a case-by-case basis. Indeed, during the interview with some investors, channeling funds from onshore to offshore has become more difficult and requires more conversations with domestic regulators. Moreover, in its last regulation, CIRC expanded its definition of "material equity investment" subject to CIRC's prior approval, covering not only investments giving rise to a controlling interest, but also equity investments reaching a certain threshold below the control level, and other investments determined by CIRC. Insurers need to be more careful buying stakes of U.S. companies.

The April 2016 (most recent) measures also included permissions for insurers to invest in asset securitization products, venture capital funds and platforms managed by professional insurance asset management

institutions. Certain insurers are also looking into these investment structures in the U.S. market, subject to what tax arrangements can be done for foreign investments.

Case Study: Anbang Insurance, who has made headlines with its \$1.95 billion acquisition of Waldorf Astoria Hotel of New York, \$400 million acquisition of Merrill Lynch Financial Center, \$6.5 billion acquisition of Strategic Hotels and \$13 billion intended acquisition of Starwood, among its many other acquisitions in tourism and financial institution sectors. Anbang started as a car insurer in 2004 and rapidly grew its life insurance business, which has longer term liability payments than property insurance and can be used to fund alternative investments such as real estate. In 2014 and 2015, Anbang's life insurance assets grew by 604% and 668% YoY respectively. Its total assets skyrocketed from RMB500 million in 2010 to RMB922 billion by the end of 2015, at a CAGR of 349%, with a record-breaking leverage ratio of 92.5%. Correspondingly, Anbang grew into one of the largest and boldest asset acquirers in the Chinese outbound space. It also becomes renowned for its ability to navigate China's bureaucracy, its top-level leadership's ambition to expand overseas portfolio, and support from well-channeled domestic funding sources.

In contrast with these high profile deals and financials, Anbang has been low profile in general about its investment strategies and decision-making process, not only in press but also during deal negotiations. For example, in its intended Starwood acquisition, Anbang rarely explained its decisions or showed comprehensive proposals. Even in the most comprehensive report on the deal published by the Wall Street Journal, Anbang's behaviors were mentioned in a mysterious way, in the similar style of Chinese government in certain dialogues. None of the relevant parties disclosed any more details, even Anbang's investment partners and advisors, which is also commonly seen in China's controlled media space.

Case Study: Ping An Insurance. Ping An Insurance is the second-largest insurance company in China, and also a leading financial conglomerate with business lines of insurance, asset management, commercial banking and Internet financing including crowd-funding, which give Ping An multiple funding sources when it comes to alternative investments. Being a cautious investor with stringent internal investment committee and reporting system, Ping An now invests less than 2% of its assets overseas, and only intends to invest up to 10% in order to manage currency mismatch risk.

Ping An conducts real estate direct investments through two separate platforms, Ping An Real Estate and Ping An Trust, who share the insurance capital while having different investment strategies and mandates within Ping An Group. According to press interviews with relevant investment professionals, Ping An targets overseas properties, logistics-related real estate and listed companies with high return prospects, with high flexibility of structures and ticket sizes. Its current investments include US\$500 million Boston Seaport development site with Tishman Speyer as development partner and China Life as co-investor (by Ping An Real Estate), US\$600 million Joint Venture fund with Blumberg Investment Partners to invest in U.S.

logistics assets (by Ping An Trust) and raising of an RMB denominated fund to invest in Pacific Eagle's two luxury condos in California (by high-net-worth individual investors and operated by Ping An Trust). Ping An is also in talks to invest in the Landing at Oyster Point in South San Francisco, one of the largest approved office and life sciences developments in the Bay Area.

Ping An endeavors to make "strategic" outbound investments and seeks strategic values and synergies with its other business lines apart from financial return. This can be seen from its investments in the logistics JV fund. Ping An has a portfolio of logistics assets in China and is one of the top five Chinese logistic property operators. Through investing in mature logistics assets and markets, it hopes to learn from the foreign experience and achieve cooperation in cross-border logistics sector. At the same time, Ping An Trust's joint venture logistics fund targets "The last mile" distribution centers in strategic urban and suburban locations, and preferably rented by highly-rated Fortune 500 companies. "The last mile" logistics is also the fastest growing sub-sector in China with the emerging e-commerce market and technologies. Through sale-and-lease-back structure, Ping An can also manage the operating risk of these assets. Another example is Ping An's fund in Pacific Eagle's luxury condos, which responds to demand from customers of its wealth management services. Similarly, state-owned Taiping Insurance also raised a fund to invest in a luxury condo project in New York, catering to their high-net-worth private wealth management clients.

iv. Domestic funds

China's relatively young but rapidly maturing private equity industry is becoming active in the U.S. market, including fund platforms with real estate as a strategy in private equity funds or asset class in mutual funds, and dedicated real estate investment managers. In general Chinese private equity funds are allowed to make direct asset acquisitions overseas, subject to regulatory approvals and cross-border funding arrangements. If they seek further opportunities in the debt and equity market as in the case of mutual funds, such as platform acquisitions and REIT shares, they need to go through Qualified Domestic Institutional Investor (QDII) program that allows approved groups to sell shares of foreign financial products to domestic Chinese investors.

- *QDII update*: The Chinese government announced the Qualified Domestic Individual Investor program (QDII2) in six cities (Shanghai, Tianjin, Chongqing, Wuhan, Shenzhen and Wenzhou), which lifts restrictions on the amount individual investors can spend overseas. Investors with over US\$163,000 of assets will be able to invest up to half the value of their total assets in overseas markets, while the limit for corporate investors will rise from \$300 million of foreign assets to \$1 billion.

Currently QDII mutual fund investors active in offshore real estate markets include Penghua United States Real Estate Fund (first domestic fund dedicated to U.S. REITs and real estate stocks), Lion Fund Global Real Estate, two funds from GF Fund Management (first domestic fund tracking the MSCI US real estate

investment trust index), and a fund from Harvest Fund Management, among the 32 approved QDII funds in total. These funds are reported to invest in large cap REITs with either top-quality assets or luxury home building business, including Simon Property Group, Host Hotels & Resorts, Meritage Homes, UDR, Extra Space Storage, Public Storage, Boston Properties, Prologis and Equity Residential. Simon Property Group, in particular, received investments from all these funds. Although the QDII funds are currently active in the equity market, they are funded by Chinese retail investors through direct subscription or commercial bank products, who are highly vulnerable to domestic stock market movements. Large-scale withdrawal from these retail investors will force QDII funds to pull back their equity holdings offshore as well, a phenomenon unique to the highly un-institutionalized secondary market in China. This also partially explains why these funds tend to invest in secondary market instead of direct portfolio acquisitions which limit their liquidity to satisfy domestic fund withdrawals.

There are also private equity funds focusing on asset acquisitions, such as Cindat Capital Management (private equity arm of China Cinda Asset Management which is asset manager for China Construction Bank), China Orient Asset Management (asset manager for Bank of China), Elite International Real Estate Investment Fund (backed by China Minsheng Bank), Grand China Fund (backed by two major Chinese developers) and CURA Investment (funded by members of China Real Estate Developer Association and JV partner with Vanke USA). Having a sponsor LP with financing support and industry resources is a significant advantage in fund raising for these domestic funds. Compared with domestic insurers who have to deal with layers of investment committees and domestic developers who have to address synergy with their onshore portfolios, these domestic funds can be highly flexible in terms of asset selection criteria and investment decision-making process, and mostly choose a few subsectors as their investment mandates in order to market to their LP partners, especially the sponsor LPs who have veto power for strategic directions of the fund.

Regulatory hurdles and restrictions remain and make it difficult to easily aggregate RMB funds onshore in China to invest on a cross-border basis. Consequently, the first wave of outbound China private equity fund investment in real estate will be U.S. Dollar-denominated funds formed outside of China but largely funded by Chinese individuals or companies who have U.S. Dollar resources located offshore from China. As more Chinese companies and investors have available RMB offshore (mostly in Hong Kong) through their investment activities or business operations overseas, we may expect more RMB-denominated funds.

Case Study: Cindat Capital Management. Cindat is the private equity arm of China Cinda Asset Management (asset manager for China Construction Bank and one of the most influential institutional investors in China). Established in 2013 by two Managing Directors heading Merrill Lynch's Asia Real Estate Investment Banking business and China Investment Banking business respectively, Cindat positions itself as the advisory and asset management platform for institutional Chinese capital in their overseas real estate investments. Its LPs include China Cinda Asset Management, Taikang Life Insurance as well as some

other domestic fund of funds and high-net-worth individuals. The two founding partners leveraged on their deep industry relationships and connections, both international and domestic, and set up a Westernized asset management platform. Cindat exclusively makes financial investments and seeks to work with local development and investment partners, preferably “mid-sized, emerging and passionate local developer / operations with significant skin in the game”, accordingly to Cindat’s statement in its website.

Cindat’s current portfolio includes five luxury residential condo towers in New York, one Class A office building in Chicago, one luxury residential condo tower in Chicago (partner with Zeller Realty Group) and 70% preferred stake in a bundle of seven mid-end hotels in New York acquired from Hersha Hospitality Trust (Hersha will remain as operating partner). For its most recent hotel investment, Cindat prioritized the balance between operating cash flow, profitability and capital expenditure requirements, and chose mid-end hotels instead of luxury hotels commonly preferred by Chinese investors. For all its investments, as a pure financial investor, Cindat takes a realistic view of its financial return, instead of “strategic values” or “leaving footprints through landmark transactions”, which is its most important mission as the outbound investment arm of China Cinda who manages China’s bad debt and needs to beef up its balance sheet.

Case Study: Penghua United States Real Estate Fund. Penghua has started raising funds called King Apex Group Holdings since 2013. Fund II, Fund III and Fund IV, totally US\$23.6 million, all targeted placement shares and convertible bonds issued by Reven Housing REIT, listed in OTCBB. When Reven Housing REIT filed its conversion listing to NASDAQ, Penghua funds were holding 89.6% of its stake and four board seats out of six. Reven Housing REIT also becomes the first U.S. REIT controlled by Chinese investors. The three funds still maintain their holdings in the REIT and enjoy the tax benefits as well as steady dividend payments from the REIT’s growing single family rental business. According to Penghua, the main reason why they invested in an established REIT rather than making direct portfolio acquisitions is the operating platform and local expertise provided by their REIT partner, similar to the reason behind acquisitions made by Chinese institutions as a financial investor. Reven Housing REIT specializes in acquiring already rented single housing properties at discount price or price close to cost, targeting a price range of US\$60,000-US\$150,000, gross rental yield of over 15% and occupancy of over 95%. These acquisition criteria are in line with Penghua’s internal requirements and Reven can effectively conduct asset selection and execution transactions on Penghua’s behalf. Currently Penghua just raised Fund V and will continue to raise Fund VI and VII, all dedicated to Reven’s equity fundraising. Majority of the LPs of King Apex Fund series are China-based, including institutional and retail investors.

v. Commercial Banks

In recent years, Chinese banks increased cross-border activity in lending for real estate acquisitions, recapitalizations, and construction and development. In the U.S., the banks have amassed at least \$8 billion in

loans and have become a major source of funding for large commercial real estate projects, extending beyond Chinese investors and projects with Chinese partners, as leading Chinese banks are active competitors with U.S. and international banks and private sources of capital in the commercial property market. One business advantage of these Chinese banks with overseas branches is the mechanism to underwrite loans for Chinese institutions guaranteed with assets held in China and credit underwriting in China, although the process is highly subjective to the banks' internal approval and regulatory approval.

Bank of China and Industrial and Commercial Bank of China (ICBC), two major state-owned banks, are the FDIC-insured institutions providing the bulk of financing, both for development in the form of construction loans and permanent loans, and for acquisitions. Bank of China's U.S. commercial real estate loan portfolio reached \$7.84 billion as of 2015, and ICBC had a loan portfolio of \$513 million. China's major policy banks, such as China Development Bank and the Export Import Bank of China, also established policies to provide financing for large real estate development and infrastructure projects in both developed and emerging markets. The Chinese policy banks will typically become involved in financing deals by teaming up with major Chinese building contractors such as China State Construction Engineering Corporation and China Railway Construction Corporation Limited. A construction bid from a Chinese building contractor may come wrapped with a proposal for financing from the Chinese bank. Select the building contractor on the deal and the Chinese bank will provide construction financing on very attractive terms. The financing vehicles will help earn returns on China's foreign currency reserves by channeling these reserves into foreign real estate loans, taking project risk comparable to domestic real estate loans. At the same time, the arrangements will help support the Chinese economy by enabling contractors to win major deals.

Although Chinese commercial banks tend to work with Chinese developers and invest managers in the U.S. market, they have recently reached out to non-Chinese institutions, leveraging on the accumulated local relationships. However, the underwriting standards and business terms employed by Chinese banks tend to be different from practices by mainstream U.S. banks, and the cost of borrowing can be higher as a result of greater risk assumed in underwriting and asymmetric information, which make them generally uncompetitive. Currently their non-Chinese lending exposure is largely limited to syndicate deals with U.S. banks, where they are in the position to lend on similar terms.

Case Study: Bank of China. This state-owned bank and also the world's fourth-largest bank by assets, has lent to Chinese investors in multiple cross-border deals, and also targets to expand its lending business to U.S. blue-chip companies across all sectors. Its recent borrowers include Visa, Diamond Offshore Drilling and CME Group. The bank also aims to cover businesses of corporate finance and commodity hedging. In May 2015, Bank of China moved its U.S. headquarter to 7 Bryant Park in New York which it acquired in 2014 for US\$600 million, and is now planning to recruit a larger team on the West Coast and set up a branch in Houston where many Chinese oil companies operate. Some of its landmark lending deals include an

US\$87 million loan to Loews Hotels & Resorts for a hotel on Sansome Street in San Francisco, a US\$30 million loan in March 2015 for Club Quarters in World Trade Center New York, a US\$314 million loan to the property owners of 63 Madison Avenue to fund their renovation plan (the fourth time it has lent on the same property) and the lending to China Orient Asset Management's US\$216 million acquisition of 61 Broadway in New York (partnering with SL Green). A potential advantage of Bank of China's lending business for Chinese investors is "onshore-guarantee offshore-lending", where Chinese borrowers use their assets in China as guarantee and receive funding in the U.S., a mechanism facilitating Chinese companies' cross-border acquisitions, subject to stricter borrower and underwriting due diligence and relevant regulatory approvals. Borrowers may also be required to pay extra hedging fee to manage the currency mismatch risk.

It remains to be seen whether the bank representing ambitions of China's financial institutions will also extend its investment management business to the U.S. market, when it successfully becomes a multi-service intermediary and has the capacity to extract the synergies between services and investments in terms of due diligence and relationship.

vi. Construction Companies

Historically, Chinese construction companies operating in the U.S. have been focused largely on infrastructure projects. However as they gradually build up their market share in the construction business and expand business relationships, they tend to follow the homeland tradition and step into development and investment businesses. Their advantages include industry relationships, construction expertise which enables them to develop without local development partners, financing support from major policy banks and credit sponsorship from a leading construction parent company. At the same time they also prefer to work with advisors and service companies to navigate through the complicated development exercise, as commonly seen among Chinese traditional State-owned-enterprises. Major players and deals so far include:

- China Construction America (subsidiary of China State Construction Engineering Corporation, the second-largest global contractor by revenue in 2015), through its investment arm called Strategic Capital, acquired an operating luxury apartment community in Houston and three residential parcels in New Jersey. Strategic Capital aims to build a U.S. portfolio of \$3 billion through acquisitions and development within three years.
- China Harbor Engineering (subsidiary of China Communications Construction Group) acquired a development site for a major office and retail project in Oakland, California.
- CCCC International USA (another subsidiary of China Communications Construction Group) purchased two mixed-use development sites in Miami.

- The US arm of Shanghai Construction Group partnered with Kuafu Properties to acquire part of 1 MiMA Tower in New York, aiming to convert the residential tower's top 13 floors into luxury condos. It also partnered with a Shanghai-based private equity fund to invest in a hotel next to Disneyland Los Angeles.
- CNMB International, together with Hong Kong-based G-Resources Group, invested 67% into ASRR Capital's Miami project in the Arts and Entertainment District.

vii. State-owned-enterprises / Private Investment Conglomerates

These investment conglomerates, whether state-owned, state-controlled or private-owned, commonly started in a few industries and successfully grew to be an industry leader. They then looked to diversify their business and expand or invest into various industries, with real estate as a popular option for asset allocation in China. Along with the releasing of cross-border investment regulations and support of favorable financing terms resulting from their corporate credit and business size, they have more flexibility to initiate deals in the outbound market, and benefit from geographic diversification, investment returns and potential synergies with other assets. In the case of SOEs, they act partially on behalf of China's "going global" expansion macro strategy and have been active in purchasing assets which can provide access to new lucrative markets. For private corporates, they are more return driven and keen to diversify their portfolio to mitigate the risk of slowing down domestic economy. Most successful Chinese private conglomerates also hold a sizable property portfolio and real estate development business in China. These conglomerates share similar incentives with Chinese developers we discussed above, in terms of business synergies, meeting customer demand and seeking development yields. Key transactions in this category of investors include:

- State-owned-enterprise: HNA Group, the Chinese airline and travel conglomerate, acquired business lines covering hospitality, tourism and technology, as well as the office building at 850 Third Avenue, the Cassa Hotel and the office building at 1180 Sixth Avenue, all in New York. HNA Group will also set its HBA Capital division's U.S. headquarter at 850 Third Avenue. HNA Group holds a real estate development business in China and is fairly successful leveraging on its land resources and location advantages as an airline company. Its business ambition, however, spans across tourism, shipping, retail, real estate and financial services, all attractive-to-acquire sectors.
- State-owned-enterprise: China's largest petroleum and petrochemicals company Sinopec recently purchased an office in Houston that will allow closer collaboration with local partners. For Chinese SOEs involved in resource-heavy industries, owning the asset provides much more operating stability than renting from a third party.
- Private conglomerate: Wanxiang Group, the largest auto parts manufacturer in China, has invested in more than 60 U.S. properties since 2010, including office, retail, industrial, hotel and development sites. The company recently formed a partnership with Geolo Capital, a private equity firm controlled by Hyatt heir

John Pritzker, to invest up to US\$1 billion in hotels. Wanxiang began to export to international markets in the 1990s and became one of the earliest groups of Chinese corporates with overseas business ties. Similar to other sector leaders, it expanded into multiple industries and has a current portfolio of automotive, renewable energies, financial services, agricultural products, international trading, natural resources, real estate and private equity / venture capital.

- Private conglomerate: China Oceanwide Group, which started as an economic reform investment agency for the Shandong provincial government, rapidly became an active investor in various listed companies in China and expanded across infrastructure, real estate, financial services, natural resources, private equity / venture capital, trading, electronics and property management businesses. Oceanwide recently acquired Fig Central in Los Angeles for hotel / condo development as the beginning of its U.S. venture. A similar case is Fosun Group, the largest non-state-owned conglomerate in China by balance sheet size, which recently invested Chase Manhattan Plaza to embark its U.S. real estate expansion. Fosun has been actively investing in financial services and tourism sectors in the U.S. as well as real estate assets in other mature markets, and is fully cautious about the potential over-pricing of landmark real estate in gateway cities. It is keenly looking into various opportunities but not under any KPI pressure to make deals.

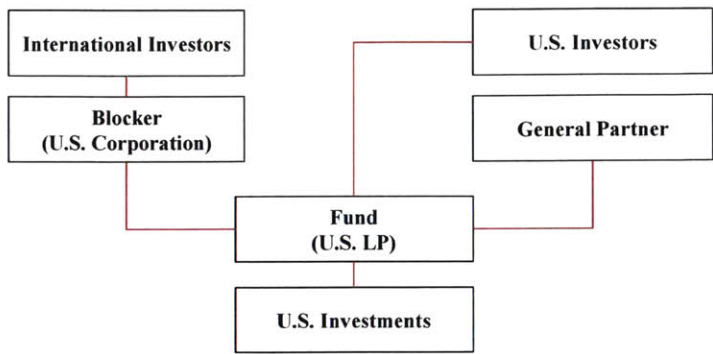
Part V – Analysis of Key Issues and Trends

i. Tax Issues in Deal Structuring

From U.S. tax perspective, investing through investment holding company (U.S.-held or foreign-held), partnership, REIT or direct lending structures have different tax implications. Choosing the most appropriate, tax efficient structure depends on multiple variables including the type of investor, type of real estate, length of investment, whether domestic investors will own more than 50% of the investment, and any applicable U.S. tax treaty with the investor's home country. Here we would like to analyze the key tax-related considerations for each type of structure:

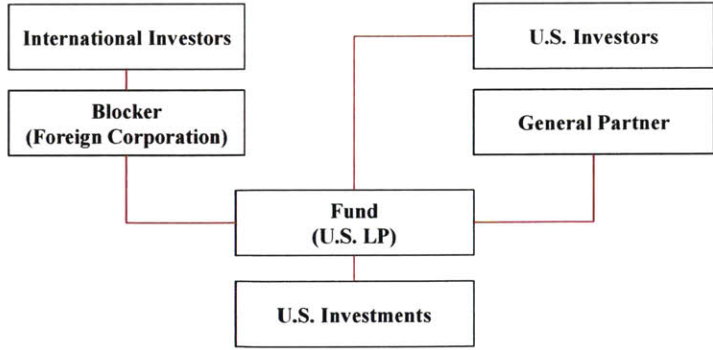
Investing through U.S. Corporation: U.S. corporations are taxable on their worldwide income on a net basis with deductions for operating expenses, at a current rate of 35-40%, state and local combined. A U.S. corporation selling appreciated real estate is also taxable on its gain at 35%. The shareholder-level tax on ordinary dividends is 30%. *(Note: although international investors may seek to use related-party financing arrangements to reduce a corporation's taxable income, there are limits on a U.S. corporation's ability to deduct interest expenses paid to related foreign persons that receive treaty protection, according to "earnings stripping" provisions in U.S. tax code).* In Chinese investors' case, the corporate income tax rate and shareholder-level tax rate can be reduced through using debt with 10% treaty rate for interest income. Further, the dividend tax often does not apply for liquidating dividends that are only paid after the corporation first sells all of its real estate assets in a taxable transaction, so investors generally hold each real estate investment through a separate U.S. corporation. Withholding taxes on distributions to non-US investors will apply at various rates depending on treaty application and other particular facts.

Structure chart: The U.S. Corporation is considered a "blocker" which prevents international investors from being engaged in U.S. trade or business and subject to tax liabilities at investor level, while the U.S. corporations are taxed at corporate level. The blocker will also be capitalized with shareholder debt, converting real estate income and Foreign Investment in Real Property Tax Act ("FIRPTA") gains into more lightly taxed interest income.



Investing through Foreign Corporation: Foreign corporations owning U.S. real estate are generally taxed on a net basis on their ECI (“effectively connected income”, or income effectively connected with a U.S. trade or business. Under FIRPTA rules, rental income from active management and gains from sale of U.S. real property interest are considered ECI) under rules similar to those applicable to U.S. corporations, or gross basis on their non-ECI (such as triple net lease income). Dividends paid by the foreign corporation are not subject to U.S. tax, while interests paid by the foreign corporation are taxed and subject to withholding tax like interests paid by a U.S. corporation.

Structure chart: The foreign corporation is considered a “blocker” which prevents international investors from being engaged in U.S. trade or business and subject to tax liabilities at investor level, while U.S. tax filings and U.S. tax payments obligations can be due from the foreign blocker. The foreign blocker might be organized as a limited partnership that elects to be taxable as a corporation to accommodate certain non-U.S. tax credit planning and/or for treaty benefits. The international investors might sell foreign blocker shares free of FIRPTA and no withholding tax on distributions from blocker to international investors.

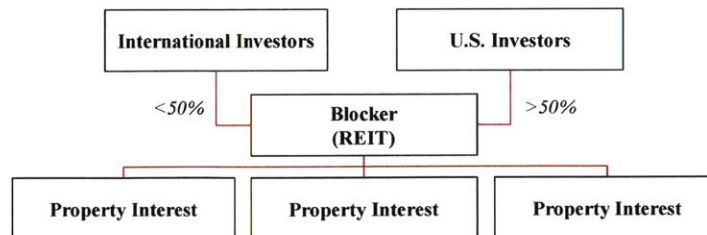


Investing through Partnerships: Partnerships are treated as an accounting entity instead of a taxpaying entity. The partners are taxed directly on their share of the partnership’s income, regardless of whether the income is actually distributed. Each partner’s tax liability is determined by his personal status. International investors investing through U.S. partnerships are subject to U.S. tax filing and reporting obligations as well as

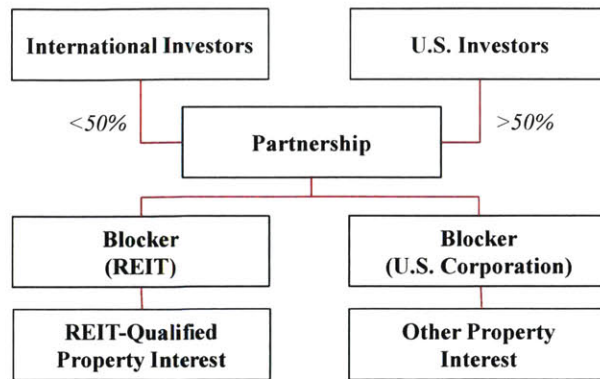
withholding rules, similar to investing in U.S. corporations. Their share of the partnership’s operating income will be treated as ECI and subject to relevant taxes. On exit, investors’ share of any gain on sale of the real estate and any gain from the disposition of the partnership interest will be subject to U.S. tax under the FIRPTA rules. There is generally no additional U.S. tax on distributions of profits from the partnership as there would be in the case of a corporation. Although the partnership structure does not give foreign investors tax planning advantages, investors still appreciate the operating efficiency and profit sharing mechanism while trying to manage their tax planning in alternative methods.

Investing through U.S. REITs: REITs are typically the most tax-efficient structures, because dividend income is subject to one layer of income tax. In the case of Chinese investors, under the tax treaty, a 10% dividend tax is applied, while investors from non-treaty countries need to pay 30%. For capital gain dividends, which occur when a REIT distributes proceeds from sale of underlying real estate, the tax treaty does not apply and international investors are subject to U.S. capital gains tax. However, investors can manage to reduce capital gains tax through structures such as “domestically controlled REITs” where more than 50% is held by U.S. persons, or funding by a combination of debt and equity taking advantage of the lower tax on interest income. In general, FIRPTA withholding rules apply to require REITs to withhold 35% of the amount distributed to foreign shareholders that is designated as a capital gain dividend by the REIT. To the extent a distribution is not designated as a capital gain dividend, the distribution is treated as a regular dividend subject to the 30% statutory withholding tax rate for dividends. Tax filings are also required for international investors.

Domestically (U.S.) Controlled REIT Structure: As discussed above, international investors holding interests in domestically controlled or U.S.-controlled REITs will not be subject to FIRPTA tax upon sale of their shares and can sell such shares free of U.S. tax. Ordinary dividends, however, are subject to withholding tax. In addition, REIT may reduce state or local taxes for out-of-state investors via dividends paid deduction.



Domestically (U.S.) Controlled REIT with Subsidiary REIT: Under this real estate fund structure, the U.S. partnership will own its REIT qualifying assets through a REIT and non-REIT qualifying assets (such as dealer assets) through a U.S. corporation.



Restrictions of REIT Structure: Apart from REIT compliance rules and additional reps and warranties required on exit, REIT structures do not allow dealer property, such as condos, which may imply 100% transaction tax. Also, there is 100% prohibited transaction tax potential if assets are sold within the two-year holding period. International investors can only exit the investment through selling REIT stocks.

Investing through Real Estate Lending: In some cases, structuring investments solely as loans could be more tax-efficient than equity investments for international investors. For example, a fixed interest rate loan to an unrelated borrower can generally be structured so that it is not subject to U.S. tax at all under the “portfolio interest” exception. Another typical loan structure is through participating loans, where foreign investors lend to U.S. property owner, which may also be operating partner of the deal, and receive contingent interests reflecting property gains. Interest amounts are not subject to FIRPTA while the loan itself is subject to FIRPTA. In this case the contingent interest is not considered portfolio interest, but interest income may have possible treaty rates. However, for all these loan structures, if the international investor is repeatedly originating loans and not merely investing in loans originated by others, then the entire investment could be subject to very significant taxes as ECI. Since there is no bright line currently for when loan originating activities will create ECI, conservative investors generally limit their lending activity to an occasional one-off single loan, having any repeated loans originated by an unrelated party (with an origination fee). Some investors also use a U.S. REIT as the lending vehicle.

High-level Summary: In general, the U.S. treats the gain or loss of an international investor from the disposition of a U.S. real property interest (including stock of a U.S. corporation that primarily holds U.S. real property) as business income that is subject to U.S. taxation. Therefore, it is generally not possible to avoid U.S. tax on the disposition of real property by holding the property indirectly through a U.S. corporation and selling its stock (taxed on capital gains). However, current rules provide for exceptions to this tax on disposition. An interest in a REIT that is “domestically controlled” may be able to be sold free of U.S. tax. Further, proceeds from the disposition of U.S. real estate investments can be repatriated to international investors in different ways, including through payment of interest, payment of loan principal, corporate

distributions, and corporate liquidations. The timing of such repatriations can result in different U.S. tax implications. For example, liquidation distributions from a U.S. corporation that has disposed of all of its interest in U.S. real estate can be exempt from further taxation. However, distributions from U.S. corporations with earnings are subject to a U.S. source withholding tax at 30% unless a tax treaty applies. As a result, exit planning will depend on many variables including the types of investors, the existence of applicable treaties, the debt and equity structure of the investment and whether the exit is partial (e.g., a sale of a single U.S. property) or complete (e.g., a sale of all U.S. properties). Below is a high-level summary of various tax implications of the main investment structures discussed above.

	Partnership	REIT	Corporations
Entity-level Tax	No	Generally no (if all income is distributed)	Yes
ECI Flow-through	Yes	Yes for FIRPTA in most cases; no on operating income	No

ii. U.S. Tax Reform on Foreign Investments

In December 2015, President Obama signed into law a measure easing the 35-year-old FIRPTA, which was established in 1980 in reaction to international investors in the late 1980s and early 1990s buying U.S. farmland, as well as the more publicly visible buying of trophy U.S. property by the Japanese. This reform act was part of the \$1.1 trillion spending measure that Congress passed to avoid a government shutdown. In order to fully assess the impacts of this reform on upcoming Chinese investments, we would like to further analyze its details, which include:

- The percentage of public traded REITs a foreign shareholder may hold without incurring FIRPTA withholding and tax upon sale of the stock was increased from 5% to 10%. Thus, any distribution from a publicly traded REIT to a less than 10% foreign shareholder would be treated as a dividend and not subject to FIRPTA tax and withholding. Further, the reform clarified the determination of domestically controlled exception to FIRPTA taxation for public traded REITs and their shareholders.
- Qualified foreign pension funds were exempted from FIRPTA tax and withholding. This new exemption applies both to a foreign pension fund's disposition of the U.S. real property interest and capital gain distributions from REITs. This exemption further applies in the case where a foreign pension fund indirectly holds a U.S. real property interest through a partnership interest ("USRPI"). The standards of being qualified include certain government regulation and reporting requirements. The new law basically allows foreign pension and retirement fund investments in U.S. REITs and real estate to receive equivalent tax treatment under FIRPTA as U.S. pension funds.

- Gains on shares in a Regulated Investment Company (“RIC”) that holds predominantly U.S. real property was exempted from FIRPTA tax and withholding for non-U.S. persons, further incentivizing foreign investors to invest in U.S. real properties.
- The rate of withholding on USRPI dispositions was increased from 10% to 15%, but this withholding may generally offset any tax due from the non-U.S. shareholder upon U.S. tax return filing.

The majority of the impacts should be on foreign investments in public REIT sector and pension fund investors. Unlike single properties or portfolios dominated by traditional asset types (office, retail, hotel and multi-family) in the eye of Chinese investors, REITs cover a wide variety of property types and infrastructure and provide above-average returns in certain niche sectors. Investors are given more options to invest as well as exit their already invested assets through REIT structures. For Chinese pension funds, it is recorded that local government pension funds had RMB 3.5 trillion (US\$540 billion) in funds under management at the end of 2014. However, there are still domestic restrictions on overseas investment by these pension funds. If the relevant restrictions are released or removed similar to the case of the country’s insurers, we could expect another major new source of cash flowing into the U.S. market.

While mainland pension funds are still restricted to domestic investments at present, authorities have already begun liberalizing the types of assets that these funds can hold, as a beginning. In August 2014, the Chinese State Council granted permission for local government pension fund to invest up to 30% of their net assets in domestic stocks, equity funds and balanced funds, on top of bank deposits and treasuries allowed before the ruling. If the investments by insurers manage to make reasonable returns in next few years, the Chinese government is highly likely to further release restrictive policies and allow for broader cross-border investment activities. The local governments are also fairly close to large real estate developers in China, and they could take the opportunity to form partnerships to jointly invest overseas.

The reforms of FIRPTA are also expected to impact demand for minority partial-interest transactions from qualified investors, as the new regulation exempts “qualified foreign pension funds” from FIRPTA taxation on dispositions and expands permissible ownership stakes by these foreign pension funds in publicly traded REITs to 10%. Over the past 35 years, many foreign investors structured their purchases to make themselves minority investors in joint ventures and bypass FIRPTA. Now under the released FIRPTA terms, they are more incentivized to make control deals and direct investments in both assets and REITs.

iii. Currency Management

There are various versions of RMB-US dollar exchange rate forecasts by different analysts, but my interviews show Chinese investors are leaning towards further depreciation of RMB in the short term, which makes US dollar denominated assets more valuable. Some U.S. investors fear that the Chinese government will react to

massive capital outflow and change its foreign exchange policy to revert the RMB depreciation against the dollar, but the internal view on the Chinese side is that the Chinese government is unlikely to see currency forecast as the top reason of increasing FDI, and that curbing FDI is not one of its top considerations when it comes to foreign exchange policy decisions, compared with impacts on foreign reserves and exports. Most Chinese investors hold a relatively long-term view for their U.S. investments and do not intend to make the perfect forecast for RMB-US dollar exchange rate in next five or ten years, although they will generally discuss and consider at investment committees and may try to pinpoint a relatively advantageous window for potential exits. Holding a certain value of US dollar denominated assets has significant strategic values in asset allocation, risk hedging and long-term business development.

However, the currency risk can be specifically critical for insurers, who have RMB-dominated liabilities and may be exposed to currency mismatch risk if investing too much overseas. As a result, although CIRC allows for 15% of insurers' assets to be invested overseas, most insurers would invest only a single digit percentage.

A separate issue for currency management is channeling the funding onshore to offshore, and property cash flows offshore to onshore. SAFE approval is required and many Chinese institutions are subject to a certain level of quota. Some asset managers, SWFs and developers have accumulated a pool of US dollar offshore, either in Hong Kong or in the U.S., and may not need to deal with this issue, but many other investors need to work with SAFE and obtain necessary greenlight. On the other hand, this serves as one of the drivers for real estate as tool of liquidity parking. A growing investment theme for Chinese asset managers and corporates is to choose a steady asset as the proxy to keep their money offshore.

iv. Granularity

As discussed in the “Emerging Trends 2016 report” published by PWC, granularity refers to investment initiatives increasingly drilling down into markets and submarkets, working with smaller assets within the larger markets, looking into specialized property types, in order to search and identify thriving niche opportunities. This trend is largely due to heated competition between various capital sources, and also appears in Chinese outbound capital space. During our interviews, most Chinese developers and investors expressed interest in digging deeper into the U.S. market beyond traditional metropolitan core assets, and taking more risks or development spreads. Their granularity initiatives include secondary and tertiary markets with booming Chinese population and corporates, alternative asset classes such as REITs, various joint investment platforms and debt instruments, redevelopment opportunities flavored with technologies and alternative property types such as senior housing and farmland, and financing structures.

One point worthy of note is the divergence of investment considerations by these institutions. Chinese firms have historically shown the effect of acting together or chasing each other in their FDI moves due to peer

pressure among themselves, but they are increasingly focusing on their own portfolio, corporate strategy, market positioning, funding support, leverage potential, and political dynamics. For some U.S. investment managers, this implies potential for expansion of the managed accounts business catering to these Chinese investors and customizing their specific granularity needs.

v. Investment in RE Technology Companies

Attention was drawn to another landmark transaction where China-based Hony Capital and Legend Holdings led the investment of \$430 million in Wework's latest funding round in March 2016, the first reported deal by Chinese capital in the U.S. real estate tech space. Although Hony and Legend focus on general consumer technology investments rather than real estate platforms, it still raises the question whether we will see more cross-border initiatives in real estate tech companies and even tech start-ups.

In the U.S., just as in many other consumer-related sectors, the venture capital is showing a greater presence in commercial real estate, especially on the customer experience end, such as brokerage, crowd-funding, market database, shared space and interactive technologies and valuation tools. According to the latest Angelist disclosure, there are currently 4,139 real estate start-ups with an average valuation of US\$4.1 million. Overall technology investment in the industry has skyrocketed from \$24 million in 2012 to more than \$1.5 billion in 2015. These investments fall into two categories: tech startups that are changing the tools of the industry and new business models that are changing the process. For the brokerage process, venture capital investments have sparked a proliferation in the number of websites enabling agents and brokers to post property listings, with the examples of VivaReal (received US\$40 million funding), the rental-listing platform Zumper (received US\$6.4 million funding) and Placester (received US\$27 million funding) which helps an individual brokerage build its online presence in order to become more accessible to consumers. On the customers' end, companies like Matterport and Floored offer augmented and virtual reality to provide realistic depictions of residential purchases through 3D models. Some start-ups are seeking to redefine services offered by traditional brokers, such as Redfin and Compass, who have raised US\$167 million and US\$118 million respectively. According to these start-ups, the future of commercial real estate belongs to efficient systems and platforms where a few consolidated global names will dominate, rather than the individual relationship-driven boutique shops. For the mainstream players, they try to take advantage of these innovations by incorporating these technologies into their own platforms, but still see the traditional relationship model a long-term play.

In general, Chinese FDI in the United States has evolved from trade facilitation (in the 1990s) and resource extraction (starting in the mid-2000s) to investment in high-tech manufacturing and advanced services, and recently further expanded into start-up space, where both Chinese corporate players and venture capital funds have shown presence. For example, Chinese e-commerce giant Alibaba recently acquired minority stakes in several U.S. e-commerce companies, and China's ZPark Venture Fund also invested in two California

technology firms, health care IT firm HealthCrowd and mobile security company Trustlook.com. However, we have not seen Chinese real estate players firming up deals with real estate tech companies, which are still relatively small in size and contradict to the philosophy of Chinese way of real estate – businesses start with and differentiate through relationships.

Another reason why we have not identified any investments by Chinese capital in the U.S. real estate technology space is the lack of expansion feasibility of these technologies to the Chinese market. For example, there are in fact many crowd-funding and online lending platforms in China, but they are dominated by national leading developers and financing institutions, and operated in completely different market rules from the U.S. platforms, implying a missing link of synergy for cross-border investments. In terms of return-driven capital, in contrast to traditional core and value-add asset deals, venture capital investment requires much higher level of due diligence and resource commitments, which the Chinese funds are not ready for and prefer to be a passive financial investor in most cases at current stage.

Nevertheless, Chinese investors have not explicitly excluded potential investments in real estate tech and are also monitoring this space, especially Chinese developers and asset managers who are seeking technologies and platforms in commercial property management, a field severely under-developed in China, or innovations in shared space, which is a heated sub-sector domestically and has also seen Wework's successful entrance in China. There are also a growing number of crowd-funding firms in New York founded by Chinese real estate professionals and targeting smaller Chinese investors interested in mature metropolitan assets. These firms spend sizable resources on investor education and marketing efforts, and it remains to be seen how well-accepted these platforms are, subject to the overall trends in the U.S. real estate crowd-funding market.

vi. The Macro Political Trends and U.S. Immigration Policies

Although the diplomatic relationship between the U.S. and China has been generally friendly for a few decades, there have been moments of tension, ranging from trade restrictions, product screenings, background and security investigations, extra taxes to direct rejection of deals. For example, in April 2016, U.S. gene-sequencing products maker Affymetrix rejected an offer by some of its former executives who were financed by China Resources Microelectronics and Hua Capital Management, even though they offered more money, on the basis of financing and regulatory risks. It went ahead with a deal to sell itself to U.S. peer ON Semiconductor for \$2.4 billion instead. For the U.S. companies, they would need to strike a balance between the need for partnership and capital and the potential regulatory and corporate governance risks brought by these Chinese counterparties.

In the real estate space where there is minimal involvement of advanced technologies and trade secrets, the concerns on the U.S. side are mainly national security, market distortion and suspicious funding sources.

Giving up equity stake and control of certain assets or platforms can add operating and asset management risk. For example, right after Anbang's acquisition of Waldorf Astoria New York, the Obama administration made the decision to break with tradition and stayed at the nearby New York Palace Hotel for September's UN General Assembly, implying a tension on the U.S. side with Chinese capital taking certain degree of control of U.S. landmark assets as well as tension on bilateral diplomatic policies. There is also widespread concern that not all transactions have managed to succeed, as Chinese companies would need to adopt the U.S. standard of disclosure and transparency, and certain Chinese companies had trouble convincing Western peers that they were credible partnership counterparties. The "cash parking" incentive of some Chinese investments has raised concerns about whether sufficient background checks have been conducted to ensure no money laundry is involved, or whether the funding is related to Chinese politics and may be pulled back overnight under the Chinese anti-corruption movement.

For Chinese investors, any potential negative changes in immigration policy are seen as significant system risk. Many of their residential investments target wealthy Chinese immigrants who are willing to pay premium for the U.S. lifestyle and potentially retired living but can hardly do so without a green card, especially for Chinese families. There are also large group of Chinese students who move to the U.S. through an F-1 VISA and are actively renting student housing properties and then downtown apartments if they are fortunate enough to win the H1B lottery. The 2016 presidential campaign has raised these investors' concerns on immigration policy to a new level, as well as relevant questions at investment committees.

vii. China's Own Political Risk

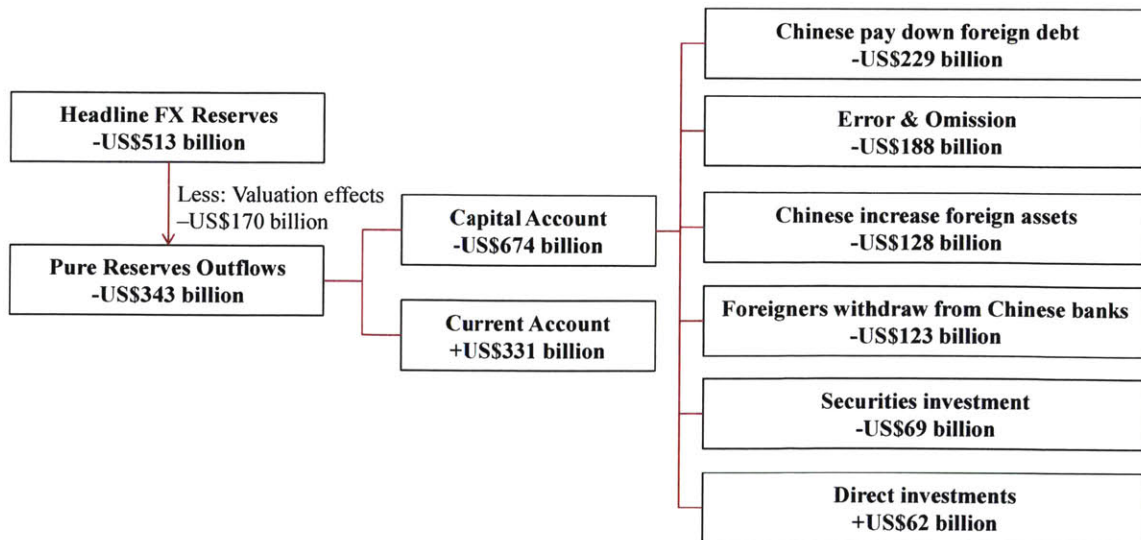
The political and economic environment in China still poses one of the largest political risks for Chinese investment in the U.S., both upstream and downstream, as the strategic directions of Chinese companies can be turned drastically overnight by one simple policy, which could tighten or loosen capital controls, foreign exchange controls, monetary policies, and corresponding US\$-RMB exchange trends, and overseas investment approval process. Another emerging risk, highlighted by the temporary disappearance of Fosun Chairman Guo in December 2015 and resulting suspension of Fosun's outbound investment initiatives, is that China's anti-corruption crackdown could shift to private companies, impacting their appetite for deals in the U.S. and elsewhere.

In Anbang's bidding transaction for Starwood, Starwood and its advisers insisted that Anbang agreed that a deal would still close, and the cash would change hands, with or without Chinese regulatory approval. Anbang agreed to the arrangement, blessed with its advantageous position in China's political system. This type of guarantee is rare and demonstrates the wariness with which some Western companies approach Chinese bidders. Also, Anbang's consent was a direct result of the bidding war dynamics involved in this transaction and its strong desire for the target. What mechanism U.S. sellers and investment partners can arrange to

mitigate Chinese regulatory risk remains one of the key issues in similar deal conversations. On the other hand, Anbang’s withdrawal of offer in the end also shows that, no matter what mechanisms are put in place, Chinese investors are subject to the political dialogues and decisions made in Beijing, only not as extreme as in Anbang’s case. Shortly after Anbang’s withdrawal, according to a source quoted by Bloomberg, CIRC was putting together a team of inspectors to look at Anbang’s business model, and announced stricter oversight of insurance companies’ investments in real estate and private equity.

Operating in a planned economy, Chinese firms tend to plan their strategic moves in line with a certain element of government support behind them, the degree of which may vary for different companies. Therefore their outward expansion should be regarded as much a reflection on the nation’s call as a result of their business strategies, which implies that the market should have confidence in the sustainability of Chinese outbound capital. That being said, many U.S. investment managers and developers are increasingly anxious about how the Chinese government views its heated FDI and the possibility of them pulling the capital-control trigger and causing massive capital withdrawal. It is interesting that the Chinese institutions we interviewed are equally or even more anxious, given their painful experience of dealing with sudden policy changes which could happen literally overnight. China did lose record-breaking US\$513 billion of foreign exchange reserves in 2015 and it would be easy to blame all the Chinese investors looking to park the capital offshore. However, according to Exhibit 10, the decline in China’s foreign exchange reserves is being driven more by unwinding of the RMB carry trade and Chinese companies paying off dollar debt, rather than the “capital escape”, which partially mitigates the risk of Chinese government shutting down cross-border investments for the sake of keeping its foreign exchange reserves, despite its more strict screening on a deal-by-deal basis to ensure the capital going offshore is strategically advantageous to China’s overall economy and industrial developments.

Exhibit 10: China’s Foreign Exchange Reserve Breakdown in 2015



Source: CEIC

viii. The Controversial Aggressiveness

Chinese investors have surprised the U.S. commercial real estate space with their aggressive bidding price or acquisition price in some headline deals, and are sometimes questioned for distorting the market and pushing down benchmark cap rates to historical lows in some gateway markets. Given the ample liquidity from capital around the world in these gateway markets and the continuing booming of the market, it is difficult to make a judgement on whether or on how over-priced are these assets, but some views I obtained during my interviews can shed some light.

In the decision-making process of some Chinese investors, the IRR hurdle and rental / NOI yield requirements, which have some kind of “industry norm rate” for assets of different risks and are the top criteria for U.S. institutional investment space, are usually one of the bullets in front of Chinese investment committees, but sometimes not the top one. They tend to give valuation premium and “strategic” premium to some landmark assets in gateway cities, and really appreciate properties with top-quality design, top-quality brand, top-quality operations or non-replaceable locations. Unlike the U.S. commercial real estate industry where property design and management has always been done professionally and up to standards, China has merely a handful of high-quality diligently-managed buildings, especially for non-residential property types, and the opportunity to invest in these high-quality buildings becomes very rare. The landmark assets, therefore, have slightly higher investment value for these Chinese investors, compared with their U.S. peers. They also invest under mixed incentives, not only returns and yields, but also cash flows, value stability, liquidity parking, cash perseverance, currency hedging, synergies with their other investments, access to market, access to partnerships, or simply the ownership of a non-replaceable asset. There may also be some internal Key Performance Indicators guiding the cross-border investment teams in order to reach certain asset allocation goals, and sometimes they are under pressure to successfully execute deals.

Being aggressive sometimes, Chinese investors see the risk of over-pricing or over-paying as seen by the U.S. investors, but this is a risk they are willing to take and underwrite at the current stage of their strategic cross-border portfolio expansion plan. “Testing through trial and error” is a mechanism widely used in the history of China’s economic reform and market opening, and Chinese investors will allow, after serious consideration, for a certain level of additional investment risk in order to set foot in a market and start building relationships. However, with the sufficient help of professional agencies and partners in the U.S. market, early movers of these Chinese investors are learning rapidly and becoming more cautious, with other investors to follow.

Another reason behind some decisions made by Chinese institutions which are seen as “non-commercial” by their U.S. peers, is the education required from Chinese investment committees, who are mostly based in

China and comprised of real estate or non-real estate professionals with limited experience with the U.S. market. It will take some time and a few deals or investment committee pitches to get them fully onboard. While hiring local teams in the U.S. has the benefit of smooth execution and strong market knowledge, it also has the downside of potential communication issues and conflicts between the New York office and the Beijing / Shanghai headquarters, leading to a delicate internal balance of power.

ix. Managed Accounts and Investment Intermediaries

For the U.S. institutions, especially developers and GPs, Chinese capital has attractive size, deep pool of players and asset management flexibility as hands-off passive financial investors, but are also sometimes difficult to fully communicate and cooperate with. Most of the Chinese investors active in cross-border space are industry leaders of various fields back in China, and have developed certain structure preferences, decision-making processes, reporting rules and investment languages, which they tend to stick to even at a completely different geographic market. One U.S. developer has explicitly expressed that they would only partner with Chinese funds which have operated in the U.S. market for a period of time and are willing to operate under the market rules here, which is not the case for all Chinese funds. In the widespread U.S. news reports about Anbang's acquisition of Starwood, parties involved in the deal also mentioned their confusion about how Anbang presented their investment case and negotiated the terms, sometimes too straight-forward yet sometimes too vague, but never sufficiently transparent.

Based on the commonly spotted communication gap and operational differences, U.S. institutional investors see managed accounts business (or separate accounts business as put by some asset managers) as the most feasible channel for Chinese capital to maximize their investment and return potential. Similar to the platform investments made by Vanke, Ping An, and some Chinese funds, Chinese institutions will contribute the bulk of capital while U.S. investment professionals will customize asset selection and asset management strategies, with or without co-investment stakes. During my interviews, some Chinese investors also welcomed this approach and have already committed or plan to commit certain capital to established U.S. investment managers on a highly selective basis. However, the transformation of mindset and building of trust could take some time, just as families and pension funds in the U.S. are comfortably giving their money to professional money managers, while the investment game in China is still highly retail.

There is also a growing number of investment intermediaries founded by Chinese professionals who have accumulated ample experience and network in the U.S. commercial real estate space. They are ready to assist inexperienced Chinese investors and developers to seek local partners, source deals, meet legal and tax advisors and even structure transactions. Although there are numerous U.S. agencies who can play similar roles, Chinese agencies have advantages in understanding how their clients operate and in serving their needs better. Through making frequent business trips to China, they could source Chinese clients on the ground and

bridge the physical gap for Chinese investors who do not operate in the U.S. yet. Although the first wave of Chinese capital is dominated by large funds and leading developers, the next wave may see the emergence of small-to-medium players who are also keen to “catch the trend” and allocate some assets, and the intermediaries will be there to satisfy their demand for investment services.

x. New Players in the Field

The Chinese outbound capital space is always changing, not only with new headlines on a daily basis, but also with new players constantly popping up in the field. During my interviews, it was fascinating to hear new names and new initiatives all the time. The existing big names are expanding their teams and setting up different platforms to pursue different products or structures. More developers, insurers and private equity funds are hiring investment professionals to explore feasible opportunities and the line has extended to Chinese real estate brokerage firms, provincial funds (similar to SWF but at provincial level), crowd-funding platforms, private wealth management platforms, and immigration financing agencies. Based on my interviews and findings, for U.S. institutions seeking to partner with these players, it is important to have conversations about their main incentives to expand overseas, internal investment budget and KPIs, availability of funding or any issues with regards to SAFE approval, sponsor backgrounds, and domestic businesses, to the maximum level of detail possible, and offer flexible partnership and co-investment structures, which they will generally be open to. These smaller players are also relatively less headline- and landmark-driven, and willing to pursue niche sectors if they deliver good returns and satisfy their particular expansion needs.

VI - Conclusions

After the rapid expansion in transaction volumes and new players entering the space in 2015, starting from the second quarter of 2016, Chinese investors are keeping the active acquisition momentum while cautiously watching the various trends in the market, which may bring positive or negative impacts on asset pricing and their decisions. In contrast to last century's Japanese investors who made equally unwise investments yet were crashed by the U.S. economic crisis afterwards, these Chinese investors are much less levered and better advised by the well-developed intermediary and institutional advisory industry in the U.S. They also have diversified investment goals and sources of capital, which help mitigate the concentration and capital flight risk. Some investors are fully prepared for long-term investments of longer term and look to hold strategic assets for a few more cycles. I have interviewed various industry professionals, both on the U.S. side and Chinese side, about their views on challenges and trends in this space. The conclusions vary greatly. Due to the confidentiality and sensitivity of this issue, I would like to generally summarize as follows. Kindly note some of the points here have been covered by the Analysis of Key Issues and Trends section above.

i. Challenges

Similar to cross-border investments in other industries, Chinese capital in the U.S. real estate space is also subject to political fundamentals, regulatory policies, foreign relations and economic cycles on both sides. Chinese investors are highly concerned about the outcome of 2016 presidential election in the U.S. and resulting changes in trade and immigration policies, while U.S. investors are trying to figure out the mysterious Chinese domestic policies on capital control and foreign exchange.

At the same time, both countries are expecting a downturn or flattening of domestic economies in the near term. How Chinese investment committees will react to a potential asset price correction in the U.S. market, especially in top-tier cities such as New York, San Francisco and Los Angeles, are yet to be seen. The Chinese economy is at a transformative stage where State-owned-enterprises are being privatized and the government is promoting various development and consolidation initiatives on the private side, which may imply an on-going shuffle among Chinese institutional investments and more strategic adjustments. How stable their outbound investments will be remains a question. On the other hand, they may transfer capital from volatile domestic portfolios to relatively mature and steady U.S. portfolios, similar to the "flight to safety" phenomenon in the asset management industry, in order to mitigate risk of domestic changes.

The communication gap between the U.S. side and Chinese side is another challenge to be addressed and I have spotted multiple misunderstandings during my interviews. Chinese players tend to strategically take a high-key or low-key approach at investment meetings, while U.S. players are used to a standardized and institutionalized straight-forward way of communication which they also strategically design. They also have

different incentives, goals and return thresholds, leading to confusion on both sides. Although some large Chinese investors are learning the U.S. way and relying on local partners or intermediaries, this gap will remain in the short term and become larger as more and more medium-sized Chinese companies enter the space. Even if these institutions hire and partner locally, the decision making process is in China and the local teams would still need to report back and seek consent in front of investment committees sitting on the other side of the ocean.

ii. Trends

After the Brexit vote, the U.S. is now seen as the most stable asset allocation destination so far, with relatively less macro risks, not only for Chinese investors but also for other international investors. A positive trend is that international capital is becoming more and more mainstream in the U.S. real estate market. Fund managers are hiring investor relations professionals to handle international capital and the brokerage industry is also becoming more diversified. More and more Chinese professionals are actively participating in the U.S. real estate space across all sub-sectors and dedicated intermediaries and platforms have mushroomed in all major markets. The pool of players will likely keep getting deeper.

Along with more diversified deal structures, platform deals where Chinese investors acquire a stake in an asset management platform will appear more often, as they realize that platform acquisitions and management provide an efficient way to obtain local partnerships and channels of deal sourcing, while maintaining a certain degree of control.

We may also see more collaboration and coordination among the Chinese players, such as syndicate deals or vertical partnerships where financial investors and developers invest in a portfolio together. Pure financial investments in top-tier assets in gateway markets are subject to record-level prices and cap rates, and Chinese investors are exploring ways to potentially take development risk or climb up the risk curve, which requires more partners to help spread the risk. An accompanying trend is that, as Chinese investors are gradually becoming more institutionalized, they are also actively looking at new property types and secondary markets, both seeking yield and diversifying their U.S. portfolios.

Last but not least, Chinese investors are trying to establish a wide array of different platforms to meet the increasing domestic demand for U.S. assets, ranging from dedicated subsidiaries, dedicated funds, dedicated U.S. dollar trusts to crowd-funding agencies and managed accounts businesses. Lack of diligent investment products in the domestic market is further pushing Chinese asset managers to look outbound for returns or simply asset stability and safety, which they fail to obtain in China as a result of depreciating RMB and waves of fund frauds. As long as there are no major negative regulatory changes, we see a promising long-term future for Chinese capital in U.S. real estate market.

List of Interviewees (name and company not disclosed due to confidentiality request)

- Representative, investment sales agency
- Broker, commercial brokerage agency
- Account manager, commercial real estate service agency focusing on Chinese investors
- Representative, U.S. homebuilder with partnership venture with Chinese investors
- Representative, U.S. commercial real estate developer with partnership venture with Chinese investors
- Investment manager, China-based insurance agency
- Portfolio manager, China-based mutual fund
- Fund manager, China-based private equity fund
- Representative, SWF research agency
- Investment director, China-based conglomerate
- Cross-border investment department representative, China-based developer
- Investment relations representative, China SOE
- Project manager, China-based developer
- Fund manager of Chinese capital accounts, managed account team of U.S. funds
- Investor relations manager, U.S. real estate fund
- Acquisitions manager, U.S. real estate fund with ventures with Chinese investors
- Acquisitions manager, European real estate fund with ventures with Chinese investors
- Representative, NAREIT
- Representative, China REIT Association
- Branch manager, China-based commercial bank
- Representative, capital market research agency
- Counsel, cross-border legal advisor
- Consultant, cross-border tax advisory
- Representative, cross-border capital research consultant
- Development manager, China-based construction company
- Business development associate, crowd-funding platform focusing Chinese capital
- Professors, MIT Center for Real Estate

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