Boston Hospitality Review

www.bu.edu/bhr

Published by the Boston University School of Hospitality Administration

Understanding the Momentum and Motivations of Foreign Investors in U.S. Hospitality

By Ken Wilson and Liya Ma

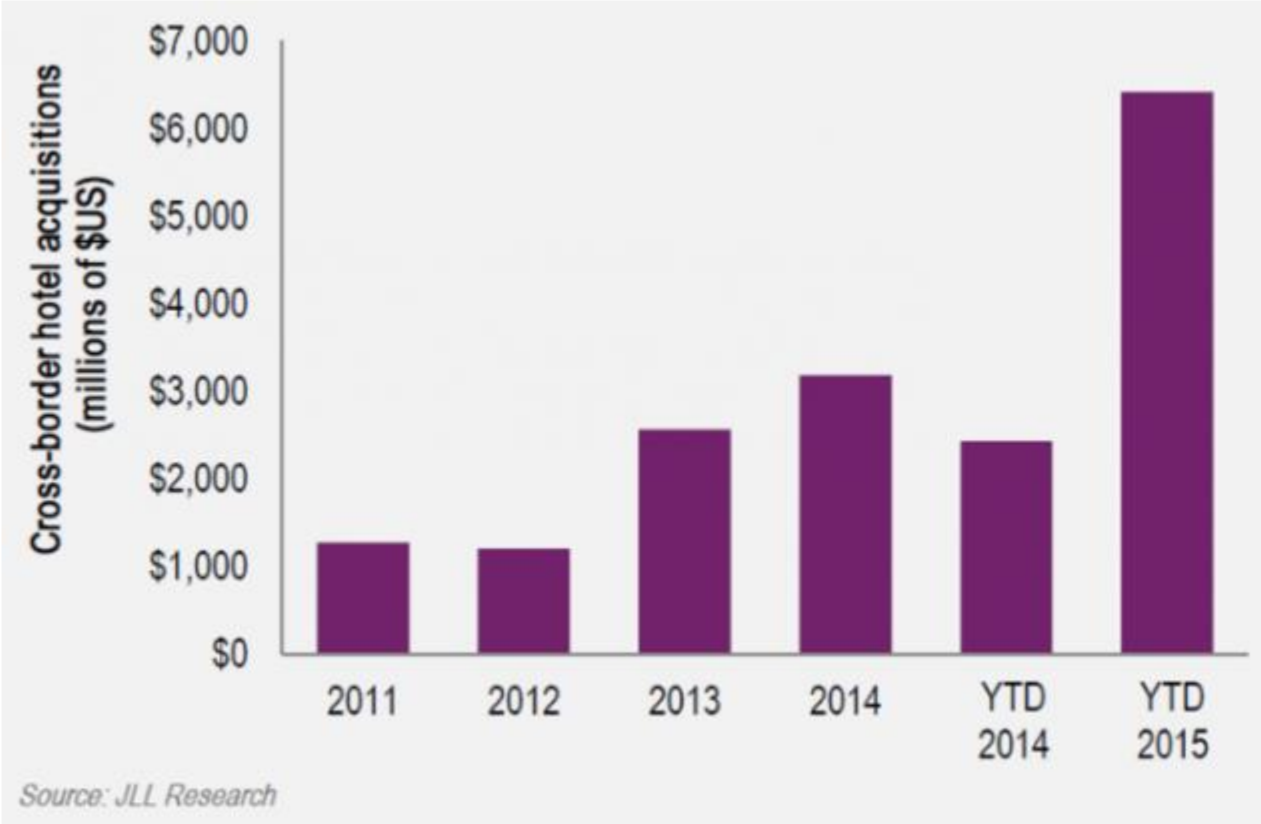
Spring 2016, Volume 4, Issue 2

1 In October 2014, China's Anbang Insurance Group caught the public's attention with its purchase of the iconic Waldorf Astoria in New York for close to $2 billion (Photo by Getty Images)

The hospitality industry has blurred national borders and transcended cultural barriers ever since transportation methods became available and affordable to consumers. In recent years, as global wealth accumulates, regulations loosen and portfolio diversification becomes more sophisticated, *investors* from around the world are also increasingly interested in U.S. hospitality as an asset class.

In 2015, total U.S. hotel transactions soared above $43 billion, largely due to full-service hotel sales in key gateway markets such as New York and San Francisco. During the first three quarters of 2015, cross-border hotel investments in the U.S. amounted to $6.4 billion, representing more than 20% of total deal volume, a 165% increase in foreign investment over the prior year period.

Cross Border Hotel Acquisitions YTD September 2015



2 Cross Border Hotel Acquisitions YTD September 2015 Source: JLL Research

In October 2014, China's Anbang Insurance Group caught the public's attention with its purchase of the iconic Waldorf Astoria in New York for close to $2 billion, and continues to be a highly active player in the market with its pending purchase of Strategic Hotels & Resorts from Blackstone and unexpected participation in the bidding war with Marriott for Starwood Hotels & Resorts in March 2016. Anbang is not alone; over the past 18 months, international buyers have made sizable hotel purchases in major markets such as New York City, San Francisco, and Los Angeles, among others.

Major Hotel Transactions by Foreign Buyers (October 2014 – March 2016)

Hotel	Purchaser	Purchase Price (millions)	Number of Rooms	Price per key (thousands)	Transaction Date
Strategic Hotels & Resorts	Anbang Insurance Group (China)	$6,500(1)	7,532	NA	Pending
Sheraton Tribeca New York	Ascott Residence Trust (Singapore)	$158	369	$428	Mar-16
The London New York	Abu Dhabi Investment Authority (UAE)	$382	563	$680	Nov-15
Fairmont San Francisco	Mirae Global Investments (South Korea)	$450	592	$760	Nov-15
Element Times Square	Ascott Residence Trust (Singapore)	$163	411	$398	Jul-15
New York Palace	Lotte Hotel (South Korea)	$805	909	$886	May-15
Edition New York	Abu Dhabi Investment Authority (UAE)	$343	273	$1,256	Apr-15
Baccarat Hotel New York	Sunshine Insurance Group (China)	$230	114	$2,018	Feb-15
The Manhattan at Times Square	Al Faisal Holdings (Qatar)	$535	689	$776	Dec-14
Marriott Los Angeles Airport	Sichuan Xinglida Group (China)	$160	487	$329	Dec-14
Hampton Inn United Nations	KFH Capital Investment Co. (Kuwait)	$72	148	$486	Nov-14
Holiday Inn Express Times Square South	KFH Capital Investment Co. (Kuwait)	$63	135	$469	Nov-14
Waldorf Astoria New York	Anbang Insurance Group (China)	$1,950	1,413	$1,380	Oct-14

Purchase price includes corporate management/asset management services.
Source: News articles and press releases.

According to Real Capital Analytics, foreign investors occupy four of the top ten active buyer spots over the past 12 months, a trend that most agree will continue.

Most Active Buyers of U.S. Hotels (Past 12 Months)

Buyer	Country	Volume (billions)	Number of Properties
1. Blackstone	US	$8.2	60
2. Anbang Insurance Group	China	$6.5	16
3. Centerbridge Partners	US	$2.8	22
4. Marriott International	US	$1.1	7
5. ADIA	UAE	$0.8	4
6. Carey Watermark 2	US	$0.8	5
7. Lotte Group	Korea	$0.8	1
8. Starwood Capital Group	US	$0.7	65
9. Mirae Asset Financial	Korea	$0.7	2
10.Carey Watermark 1	US	$0.6	7

Source: Real Capital Analytics; March 2015 to March 2016.

Characteristics of Foreign Buyers

What makes foreign investment groups different from domestic investors? While each group and each hotel investment is unique, commonalities often shared by overseas investors include:

Long-term investment approach:

Foreign groups who invest internationally tend to do so for longer anticipated holding periods compared to domestic groups. Sovereign Wealth Funds, in particular, are traditionally long-term investors funded by state-owned sources of capital. Similarly, when Anbang Insurance Group bought the Waldorf Astoria, they signed a 100-year management agreement with Hilton International, signaling the buyer's desire to build a long-term partnership with U.S. expertise.

Core markets:

As illustrated in the Major Hotel Transactions chart, foreign investors prefer core U.S. cities which are considered safe havens, with a particular emphasis on New York City, San Francisco and Los Angeles. However, as prices in these cities continue to rise and available deals are more difficult to find, other getaway cities with direct flights from major world cities and high tourism are gaining traction. For example, hotels in Miami, Orlando, Dallas, Houston, Atlanta, Chicago, and Philadelphia are now on foreign funds' radar, according to real estate advisory firm Eisner Amper. Foreign investors, particularly from China, recognize the sizable opportunity to ride the wave of increasing tourism to the U.S., which in the case of Chinese tourists are anticipated to double by 2020. This growth in travel, coupled with the growing presence of U.S. hotel brands across the globe, enhances the attractiveness of investing in properties in the states.

Luxury properties:

Foreign investors prefer luxury hotel investments for a number of reasons: Luxury brands tend to be more established and generally make safer investments compared to newer, lesser-known brands; luxury hotels tend to have higher property values, enabling international funds with large amounts of available capital to invest more efficiently; and, wealthy foreign investors who are used to the luxury hotel experience at home and abroad also prefer to be associated with luxury names in their investment portfolio. Nevertheless, when select-service hotels such as the Hampton Inn United Nations and Holiday Inn Express Times Square South in New York City went on the market, foreign groups were as active as their U.S. counterparts in the bidding process, and KFH Capital out of Kuwait came out the winner.

Why Do Foreign Firms Invest in U.S. Real Estate?

Cross-border investments in U.S. real estate totaled over $78 billion in 2015, compared to less than $5 billion in 2009, according to Real Capital Analytics. Foreign buying in 2015 accounted for 16% of total investment in U.S. real estate, about double the 8% average in the ten years through 2012.

What makes investors want to put out large amounts of capital into buildings on the other side of the world, where they must navigate through operational, legal, and cultural challenges? Factors that allure International investors into buying real estate in the U.S. include the following:

Diversification

International funds invest abroad in order to diversify their portfolios and hedge currency, political, and regional risk. Real estate is an attractive form of investment given its tangible nature, inflation-hedging track record, and easily-quantifiable valuation. Hotels have become especially appealing to these international investors given their cultural relevance and often historical significance.

Sovereign Wealth Funds in particular are founded with the sole purpose of diversification. For example, the government of Qatar created the Qatar Investment Authority in 2005 in order to manage its oil and natural gas surpluses and protect its reserves from energy-related risk. Even with depressed oil prices since mid-2014, Middle Eastern investors have continued to spend with an outbound focus.

Global Reach

Purchasing hotels in international markets allows investment firms to gain broader recognition, customer base, and market intelligence. For example, Anbang Insurance Group, a relatively unknown player on the global stage, gained worldwide name recognition after its acquisition of the Waldorf

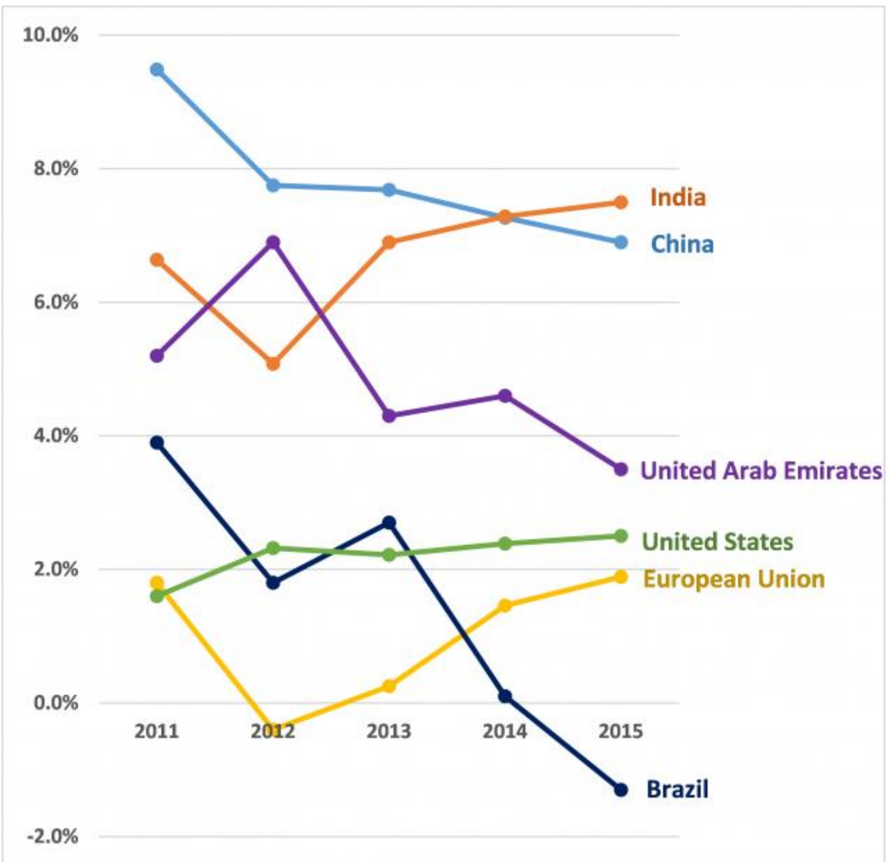
Astoria New York, which earned them extensive international press coverage and an award for "Single Asset Transaction of the Year 2015" at the America's Lodging Investment Summit, an unprecedented acknowledgement of a Chinese insurance company within the lodging industry.

United States as a Safe Haven

In short, foreign capital favors developed economies. North American hotels were the recipient of capital inflows totaling $7 billion in 2015, second only to European hotels with capital inflows of $12 billion, according to Jones Lang LaSalle. The U.S. ranks among top destinations for foreign investment as it remains one of the largest, most liquid, and most stable markets for investing.

As the graph below shows, the U.S. economy has experienced steady growth in recent years at a pace of 2.2% in 2013, 2.4% in 2014 and 2.5% in 2015, whereas growth in major economies such as China, United Arab Emirates, Brazil and Russia have been negatively impacted by difficult global economic conditions.

GDP Growth of U.S. against Major Countries/Regions



Source: World Bank (Real GDP growth at 2005 price).

The U.S. hospitality sector's strong fundamentals and favorable demand/supply balance continues to draw international investment into the US now and into the foreseeable future. According to the Chairman of Singapore's Ascott Residence Trust, whose firm recently purchased two hotels in New York City as their first U.S. acquisitions, "with future demand growth expected to continue to outpace supply, we are confident that this acquisition will further enhance Ascott REIT's portfolio and Unitholders' returns." Ascott targets to increase their U.S. investments up to 20% of their total portfolio by 2017, which represents approximately $570 million of additional acquisitions.

The Multiplier Effect of Real Estate Value Appreciation

As long as real estate maintains value, investors benefit from capital preservation and recurring cash flow distribution. Investors further benefit when real estate holdings *appreciate* in value. Average growth rate for U.S. hotel values was 7.2% in 2015, and is expected to be 5% in 2016 and 6% over the next 4 years, according to the HVS/STR Hotel Valuation Index.

On top of the multiple layers of benefits, as the global reserve currency, the U.S. Dollar is a safe bet especially for emerging market investors whose native currency may be at risk of depreciating in value. For example, the recent rise and fall of China's currency is the result of Chinese investors eagerly trying to get their money out of a country they believe is slowing down dramatically.

RMB per 1 USD

Source: www.xe.com

The exchange rate of Chinese renminbi (RMB) per U.S. Dollar (USD) rose from 6.05 on January 4th 2014, to 6.54 as of January 4th 2016, representing an appreciation of 8% in the USD's value against the RMB. Suppose a Chinese investor acquires a U.S. hotel for $200 million in cash in the beginning of 2014. It must first convert its RMB into the Dollar at the 6.05 exchange rate. Applying HVS/STR's 5% average annual value appreciation, the hotel will be worth $221 million in two years. Better yet, adding the effect of currency appreciation, the Chinese investor's U.S. Dollar-denominated investment will be worth $238 million in two years. The difference between $238 million and $221 million ($18 million in two years) illustrates real estate's ability to serve as a currency hedge and to increase value through a multiplier effect.

Hypothetical Example of Real Estate Value Appreciation

	1/4/2014	**1/4/2015**	**1/4/2016**
Original Investment	$200M		
Annual Value Appreciation		*5.0%*	*5.0%*
Value with Annual Value Appreciation		$210M	$221M
Currency Appreciation (cumulative)		*5.3%*	*8.0%*
Value with Annual Value and Currency Appreciation		$221M	$238M

Source: CHMWarnick
Note: This simplified illustration does not reflect cash flow distribution from hotel operations nor factor in time value of money.

More Favorable Regulations

In order to encourage foreign investment, in December 2015, President Obama signed into law a measure easing a 35-year-old tax on foreign investment in U.S. real estate. Under the previous rules of the 1980 Foreign Investment in Real Property Tax Act (FIRPTA), foreign majority sellers had to pay 10% of gross proceeds from all sales of U.S. real estate. Jim Fetgatter, chief executive of the Association of Foreign Investors in Real Estate, believes the change to be "a huge deal" and will undoubtedly increase the amount of foreign investment in U.S. property.

The U.S. isn't the only country that is loosening restrictions on foreign investment. The Chinese government, which historically forbade insurance companies from investing abroad, has gradually eased its restrictions and now allows companies to invest up to 15% of their assets offshore. In May of 2014, the Chinese government further lifted a $100 million approval threshold to $1 billion, giving Chinese firms the freedom of investing up to $1 billion abroad without the need for government approval. As a result, according to the Rhodium Group, mainland Chinese investors pumped over $5 billion into U.S. real estate and hotels in 2015, an increase of more than 65% from 2014, a trend that is likely to continue.

What Services Do Foreign Investors Need?

Foreign investors face a number of challenges in the U.S. as they look to purchase and work with hotel investments with operational complexities, especially if they do not have existing local presence or previous hospitality experience. Therefore, it is critical for foreign investors to work with locally-based experts both before and after an acquisition. The following are some of the most important aspects for foreign investors to consider:

Timely and thorough due diligence:

Foreign investors' deal teams need to report back to their headquarters abroad for approval, and yet must operate within the same time constraint as domestic competitors in the bidding process. To them, time is of the essence, but an overseas investor cannot acquire full market knowledge overnight, and a rushed due diligence process can lead to hidden problems down the road.

In addition, compared to domestic bidders, a foreign buyer may be perceived to have greater uncertainly of closing a deal, or have more pressure in putting out their capital, thus is more likely to be pressured into paying a higher premium.

Therefore, having local representation by experts who are experienced in working with brokers, brands, lenders and third party consultants and who can outline the risks/upside will be essential for foreign firms in the due diligence phase to ensure that they pay a fair price and are able to close the deal.

Negotiate favorable contract terms:

After winning a deal, investors cannot simply leave the contract negotiation to the lawyers. A properly drafted Purchase and Sale Agreement protects the owner's rights and ensures a smooth transition. As owners and operators have inherently different objectives, the Hotel Management Agreement is crucial in aligning interests and paving the way for a harmonious relationship.

Execution of investment strategy:

Foreign investors need local experts to coordinate and support the ownership group in the many activities that typically follow an acquisition – such as renovation/repositioning, redevelopment, implementation of operational initiatives, and legal/tax advice.

Ongoing monitoring of the operator:

Hotel operators usually get paid a management fee as a percentage of revenue, as opposed to bottom line profit, which gets distributed to the owners. As such, asset managers exist to represent owners' interest and oversee operating teams, by constantly challenging them to increase revenue, reduce cost, set appropriate annual budgets, and perform capital projects that add short and long term value to the property. As it relates to foreign investors, asset managers can be critical in navigating the litany of likely new issues that arise (labor, legal, brand relations, etc.).

While Anbang's attempt to purchase Starwood Hotels was not consummated, it demonstrated the enormous appetite for U.S. hospitality assets by global investors. As competition intensifies and price tags increase, foreign investors have to expand their playing field into additional markets and beyond the luxury hotel segment. A new stage of foreign hotel investing may be ahead of us, and whether the next overseas investor becomes our owner, borrower, partner or client, we can all be thinking about ways to reciprocate learning, foster trust, understand their business culture, and mutually benefit from this unique type of relationship.

***Ken Wilson** is co-founder and Managing Director of CHMWarnick, the leading provider of hotel asset management and investment advisory services. With more than 30 years hospitality industry experience, Ken has provided strategic vision for the company, and has served as a trusted hotel advisor to a wide-range of ownership entities including private equity, public agencies, pension funds, lending institutions, Fortune 100 companies, insurance companies and sovereign wealth funds. As a founder of the original third-party hotel asset management company, Ken has guided a team of hospitality professionals to provide unparalleled services and strategies proven to optimize financial performance and asset value throughout every stage of ownership. Today, CHMWarnick asset manages a client portfolio of more than 50 hotels, with 23,000 rooms, collectively valued at $10 billion. Ken has a successful track record in raising and negotiating equity and debt financing, negotiation of purchase and sale agreements in support of asset acquisition and disposition activity, advising on investment strategies, and hotel management/franchise company selection and contract negotiation. Prior to founding CHMWarnick, Ken was the CEO of Capital Hotel Management, and led the hospitality practice for two international consulting firms. Ken earned a Bachelor of Science in Hotel Administration from the University of New Hampshire, and is an active member of the Hospitality Asset Managers Association (HAMA), The Counselors of Real Estate (CRE) and Marriott International Ownership Advisory Board. For more information about Ken and CHMWarnick, visit www.chmwarnick.com or follow us on LinkedIn.*

***Liya Ma** is a Manager at CHMWarnick, the leading provider of hospitality asset management and investment advisory services. Liya brings 6 years of hospitality real estate finance and investment experience, with expertise in hotel acquisition, disposition, refinancing and corporate strategy. She is responsible for supporting the value creation efforts of CHMWarnick's asset management portfolio, including more than 50 hotels collectively valued at $10 billion. Prior to joining CHMWarnick she worked for Club Quarters and Magna Hospitality, as well as the lodging/consumer divisions of several international investment banks. Liya has a Bachelor of Science degree in Hotel Administration from Cornell University, a Master's degree in Business Administration from Yale University and is fluent in Mandarin Chinese. For more information about Liya and CHMWarnick, visit www.chmwarnick.com or follow us on LinkedIn.*