PEI Alternative Insight

PERE

REGULATION & FUND DOMICILES | perenews.com

FOR THE WORLD'S PRIVATE REAL ESTATE MARKETS

Survey in association with:
RBC Investor & Treasury Services

REGULATION & FUND DOMICILES

A special supplement to *PERE* magazine

Growth in spite of regulation

You think you have got to grips with the ins and outs of the latest set of regulations, then along come more to keep the compliance team on its toes. This has been the norm for the private funds sector since the global financial crisis and there is no sign of things changing any time soon. The AIFMD review is coming round the corner. Yes, again! The directive was not popular the first time round and some trepidation is already sensed about the prospect of an AIFMD II.

A more imminent arrival – and somewhat timely given the current Facebook/Cambridge Analytica furor – is the EU's General Data Protection Regulation. It comes into force in May and any company falling foul of it can expect to be slapped with harsh penalties. Investors and managers should be on top of this already. Yet one expert I spoke with earlier this year sees a lack of preparedness but no real sense of panic, particularly among many non-EU based managers.

Given the climate and the increased use of big data in private real estate, GDPR is likely to be just one in a long line of data protection-related legislation for the sector to get its head round in the near future. As one interviewee in this report puts it, the interplay between this issue and regulation is "not for the faint-hearted."

Certainly the managers responding to the *PERE* and RBC survey featured in this report (p. 7) are acutely sensitive to the disruptive impact of regulation. But another recent survey (p. 14) suggests that in the US the regulatory climate is somewhat more relaxed than it is internationally due to a lessening of enforcement. A positive Trump effect for once? Surely not!

With the global regulatory environment only set to get tougher and the political climate, especially in Europe, still uncertain, it is not surprising to find fund managers are sticking with safe and familiar domiciles for new funds. Delaware and the Cayman Islands continue to be favored and, in Europe, AIFMD has ramped up interest in Luxembourg as a domicile. The Channel Islands are also rapidly capitalizing as the Brexit game plays out.

Despite the continued regulatory pressures and anticipated disruptions from it, money is continuing to flow into the private real estate space, and from an increasingly diverse range of sources. As our survey shows, eyes are turning to Asia in particular as a capital source. Overall, growth expectations for the next decade are high and there is much to be positive about.

Enjoy the report!

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Regulatory enforcement of alternatives down under Trump

Most fund execs in a Koger study said regulatory and compliance issues were less of a concern under the administration. By Nathan Williams

The enforcement of regulations for alternatives managers has diminished under the Trump administration, according to a survey of 200 private equity and hedge fund executives by financial services technology company Koger.

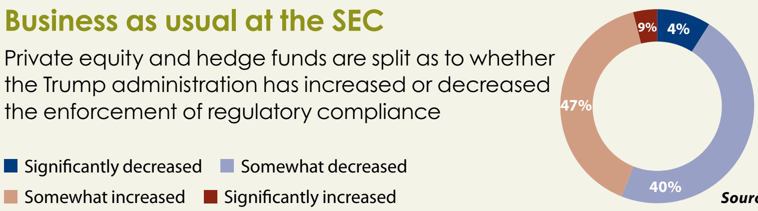
Fifty-six percent of executives at private equity and hedge funds said regulatory enforcement has decreased under the current administration. Eighty-five percent viewed the US regulatory environment as more relaxed than it is internationally. Nearly 80 percent of funds questioned said regulatory and compliance issues are now less of a concern than in the past.

"The mandate of the Trump administration generally has been to relax business regulation and this tendency has been evident in the financial sector. In fact, it was reported that in March the US Senate is looking to roll back significant financial regulation passed since the financial crisis. In this overall climate, our study has shown a corresponding decrease in enforcement," Ras Sipko, Koger's chief operating officer, told *pfm*.

The findings are consistent with the shift in focus from private fund manager compliance to retail investors, which was reflected in the recent budget request by the SEC. Underscoring the uncertainty around enforcement, 73 percent of respondents said that they believe a new administration is likely to strengthen regulatory enforcement in the future. □

Business as usual at the SEC

Private equity and hedge funds are split as to whether the Trump administration has increased or decreased the enforcement of regulatory compliance



Source: *Koger*

The SEC: Still watching private funds

Private funds were not named in its 2018 priorities, but managers should read between the lines

When the Securities and Exchange Commission's Office of Compliance Inspections and Examinations announced exam priorities for 2018, there was no mention of private equity and other alternative assets. Some firms might then expect less rigor in exams and lighter enforcement after years of being a very public bee in the SEC's bonnet. That would be a mistake.

The headlines of the OCIE report don't mention the industry, but the SEC includes pension funds in its definition of retail investors, so alternative assets remain in its crosshairs. The reality is that if a GP hasn't had an exam yet, one is on the way. That exam will still treat fees and expenses as a top concern, leading to tough questions about conflicts of interest. They'll continue to scrutinise valuation and cybersecurity programmes, but now they're digging

Compliance staff should stay diligent, even if the SEC isn't calling out the industry in public, and GPs shouldn't expect exams to abate any time soon. □

NEWS IN BRIEF

1 Are you ready for GDPR?

In May, Europe sees this new data protection regulation come into force, with stiff penalties for those firms guilty of breaches. Toby Duthie of Forensic Risk Alliance says there is a lack of awareness of the new regulation among firms in the US.

2 Penalty time for overstepping Chinese insurers

Local regulators have taken harsh action against Chinese investors that have failed to toe the line on cross-border investments. There could be repercussions for their real estate holdings.

3 The BEPS effect

A change in the way private funds are structured is imminent when new rules come into force in 2019. A year ago the industry had little idea where it stood. Could funds continue to domicile in low-tax jurisdictions? OECD devised three fund examples of how the rules could apply to private equity: the regional investment platform was declared the winner.

4 Cryptocurrency investors should expect more scrutiny

The Securities and Exchange Commission is paying particular attention this year to advisors of all stripes who manage funds that have a high concentration of retail and retirement clients, including not-for-profits and pension plans. Funds involved in Initial Coin Offerings or making investments in cryptocurrencies are also on notice.

5 Indian banks get green light to invest in alternatives

The Reserve Bank of India has given the go-ahead for the country's banks to invest in private equity without seeking its approval. The RBI amended a regulation permitting investment of up to 10% of paid-up capital. Banks also received permission to invest up to 20 percent of their alternative assets allocation in real estate and infrastructure investment trusts.

Reaching new heights: the regulatory landscape is growing in complexity

Growth and complexity

Priya Nair, managing director and global head of product management for Private Capital Services at RBC Investor & Treasury Services, explores the manifold regulatory challenges faced by investors in an expanding real estate investment market. Stuart Watson reports

An ever-increasing tide of money is pouring into the private real estate space from a diverse range of sources. That influx is driving investment managers to create ever more complex fund structures to satisfy the varied needs of capital allocators, and managing those structures is no small challenge in an increasingly labyrinthine regulatory landscape. Priya Nair, managing director and global head of product management for Private Capital services at RBC Investor & Treasury Services (RBC I&TS), reflects on the nexus between capital demand and regulation, and reviews the results of *PERE* and RBC I&TS's joint survey of investment managers' domiciliation and regulatory concerns.

“If asset managers are unable to provide for investors’ needs in different jurisdictions they won’t be able to compete with their peers that can”
Priya Nair

PERE: How is the increasing demand for real estate investments influencing the regulatory challenges facing asset managers?

Priya Nair: The real estate asset class continues to grow not just in terms of absolute numbers but also the complexity of the business. An influx of new investors is happening at a time when new types of structures are coming online and there is an increasing need for transparency and reporting. As that growth continues asset managers need to think about how to provide and manage structures that are more sophisticated and less standardized than they were in the past in order to capture more diverse sources of capital. With growth comes complexity and the need for asset managers to navigate a landscape of intricate regulatory and accounting rules.

The *PERE*-RBC I&TS survey of investment managers demonstrates that there is a growing focus on, and interest in, real estate as an asset class. We are going to see sustained growth in allocations from existing investors. Meanwhile, asset managers that were not previously looking at this asset class are going into the real estate arena. That allocation is if anything getting bigger over a 10-year horizon: 79 percent of managers surveyed said they would grow their private real estate assets under management by more than 31 percent over that period.

That appetite is largely driven by macro-economic factors, such as the chase for yield in a low interest rate environment and demographic trends like urbanization. Real estate is also seen as resilient to future interest rate rises and other macro-economic shocks because it is perceived as uncorrelated to more traditional assets classes. That means it acts as a diversifier away from fixed income and equity listed instruments if there should be a negative shift in the economic climate.

***PERE**: Does the survey demonstrate a change in the type of capital flowing into real estate?*

PN: The increase in that allocation continues to be largely from institutional and corporate investors, but there is now a focus around other sources of capital including the retail fund segment. Of the investment managers surveyed, 47 percent expected that the proportion of their investor base made up of retail investors to increase. The steady increase in allocations to real estate among institutions is not a surprise. A lot of these investors are pension funds that want to match their liabilities in the long term by using the stable cashflows that real estate provides. However, it is hard to glean whether this is new money coming in or existing investors increasing their allocation.

Managers also expect a large increase in the proportion of Asian capital. Increases are also anticipated from North American and European-based investors, although at a lower level. That may reflect the maturity and depth of the demand for real estate investment that already exists in those markets, but a steady increase is expected nonetheless. I suspect that the predicted influx of Asian capital will include a number of new entrants from the region's pension funds, sovereign wealth and high-net-worth family office investors. The dynamic demographic-led growth in the Asia-Pacific region means the cashflow that can be generated by investment strategies there is useful in terms of liability matching for the pension funds.

***PERE**: How is investors' choice of fund domiciles evolving?*

PN: We are seeing European institutional investors requiring more regulated structures and that creates the need for third-party banks to act as depositories. When that is combined with the potential consequences of Brexit and the need for structures to be compliant under the AIFMD and other EU directives, that makes the choice of jurisdiction even more relevant. A large proportion of the industry is still domiciling funds in Delaware and the Cayman Islands, but other jurisdictions are becoming more relevant, particularly where asset managers are looking to raise European investment capital, namely Luxembourg and the Channel Islands. The results of the survey show a surge in funds domiciled in Luxembourg, with nearly a third of respondents saying that they will use it as a domicile for their next private equity real estate fund.

Historically, Asian investors have been focused on the

Nair: seeing a rise in retail investors

Delaware and Cayman Islands domiciles. As the weight of Asian capital increases it will be interesting to see if they are captured by similar requirements to the ones that European investors need to fulfil under AIFMD. That might change how they think about domiciliation in the future. When the growth in an asset class is at a nascent stage there are fewer requirements in terms of regulatory compliance, but when there is an increased allocation to a segment of the market from a group of investors, as is currently the case with Asian capital and real estate, it drives a lot of interest from regulators that want to ensure the appropriate safeguards are in place.

***PERE**: What are the main regulatory headwinds that investment managers face?*

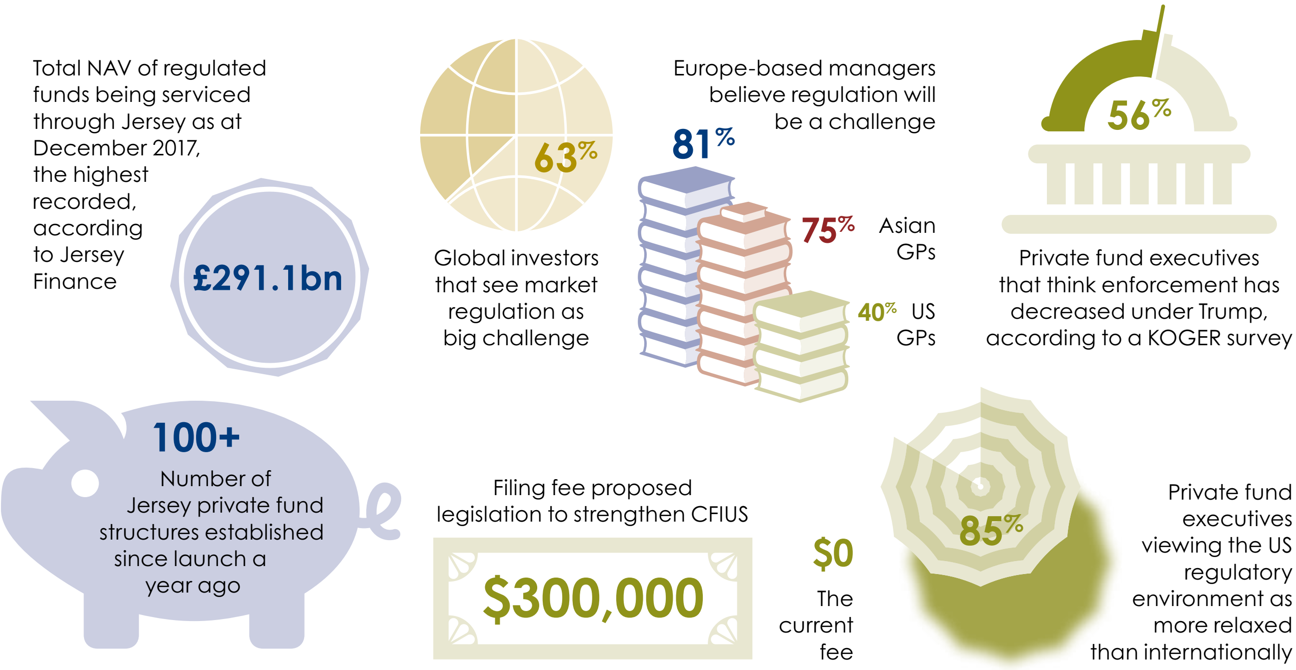
PN: Most of them are around transparency and reporting requirements with regard to regulations that are coming in like the European Union's General Data Protection Regulation and directives that are already out there like AIFMD. Investors are operating lots of different structures in different domiciles, so the need to be transparent, do more reporting and comply with accounting rules in various jurisdictions definitely changes how investment managers run their business operations and allocate resources. Some vehicles may be the first structure of that type in a particular jurisdiction so there is a lack of standardization across different regulatory environments. If asset managers are unable to provide for investors' needs in different jurisdictions they won't be able to compete with their peers that can.

***PERE**: What strategies are managers adopting to deal with that organizational challenge?*

PN: They will need to focus more on some of the technological tools available to enhance their offering, serve clients better and become more efficient. The survey highlights the importance they are placing on technology and data management strategies to provide them with the means to comply with regulatory requirements. As a consequence, managers are considering entering into outsourcing partnerships where they can leverage outsourcers' investment in technology and free themselves to focus on fundraising and investment strategy. The survey results show that in the next 12 months some of the areas investment managers would like those partnerships to be focused on are regulatory services and data management. □

2018: a challenging year for regulation…

… but not so much for US managers, according to Augentius survey



QUOTABLES

"It's clear from the data that fund managers see the regulatory and enforcement climate as having eased in the US, especially compared with that in the UK and Europe"

Ras Sipko, KOGER chief operating officer discusses the results of the company's survey of 200 private equity and hedge fund executives

"Funds that are involved in initial coin offerings or making investments in cryptocurrencies are on notice for increased scrutiny"

Ken Joseph, Duff & Phelps, and former head of SEC's New York Regional Office Investment Management Examination Committee

"I have a rule of thumb. If it's a warm, sunny island with a nice seashore, it's hard to demonstrate substance. In contrast, onshore jurisdictions have a real depth in human, technical and economic resources to go with a varied economy and are therefore more likely to be aligned to reality"

Prabhu Narasimhan, tax partner, White & Case, discusses the BEPS effect with sister magazine *pfm*

"The main barriers to the cross-border distribution of funds, as identified by asset managers and investors, are the lack of clarity and transparency of existing rules, along with additional layers of regulatory requirements imposed at national level. Today's proposals unfortunately adds yet a new layer of rules"

Peter De Proft, European Fund and Asset Management Association director, is not a fan of the European Commission's proposals on cross-border distribution of funds

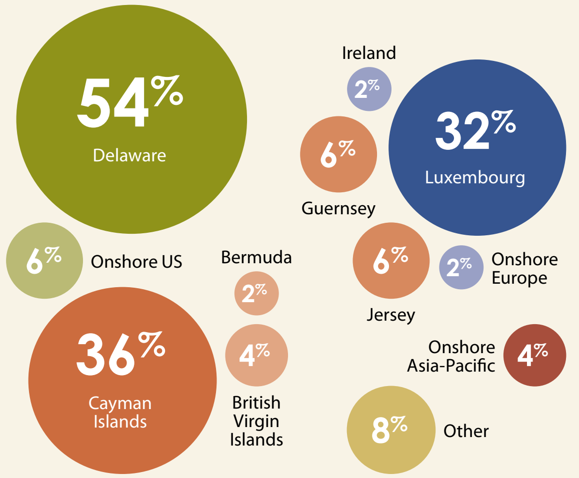
Keeping the faith

In an exclusive survey carried out by *PERE* in association with RBC, managers reveal how they are sticking with familiar fund domiciles at a time rife with potential regulatory disruption

The private real estate sector has a watchful eye on how regulation, data and technology are impacting business. These factors exert unprecedented pressures on fund managers' operating environments, across all alternative asset classes. Given this uncertain climate, managers are opting for traditional domiciles – with familiar tax and regulatory regimes, and optimal conditions for doing business – for their next funds. Yet despite the potential for disruption, fund managers that responded to this survey are not expecting it to negatively impact performance over the next decade.

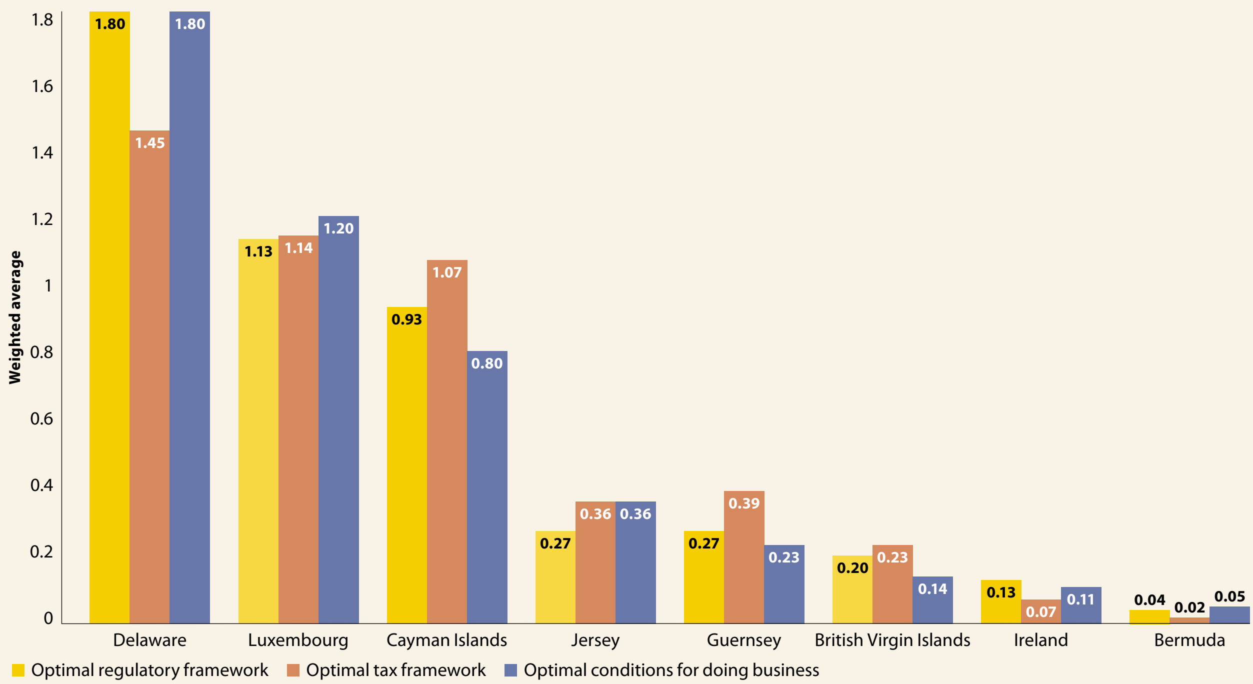
Delaware is the domicile of choice for a clear majority of respondents: 54 percent intend to register their next fund in the US state. It is clear why from the survey data. The US state is seen to offer optimal conditions for doing business, and the most favorable regulatory and tax frameworks. It is worth keeping in mind the majority of respondents are headquartered in North America, which may have had an influence over choice. Nevertheless, it is a vote of confidence in Delaware as a business-friendly jurisdiction.

Which domicile will you use for your next PERE fund? (select top three)



Source: *PERE*

Which top three domiciles offer the following in 2018?*



**See methodology on p. 10*

Source: *PERE*

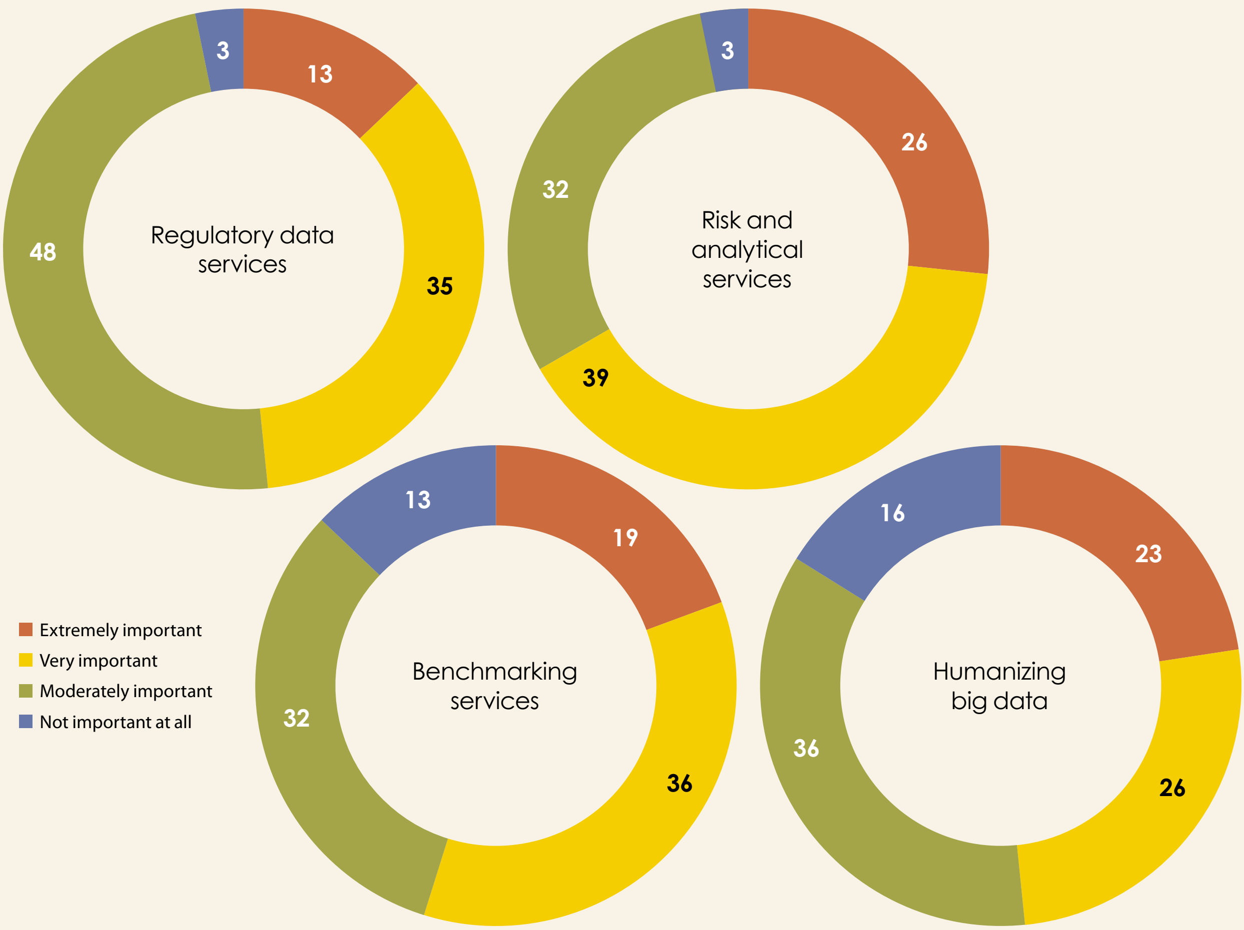
Disruptive times

The growing use of big data and technology is translating into more regulatory pressures and greater disruption

With regulation around the use of data tightening – think GDPR – it is not surprising that data management strategies, particularly regulatory data services and risk and analytical services, are considered as at least moderately important by most survey respondents. In response to these pressures, and perhaps an indication of a perceived skills gap in-house to handle these issues, 27 percent of respondents are intending to increase their outsourcing of these activities in the coming months. None of the respondents plan to decrease outsourcing of regulatory and legal services, and only 3 percent are planning to decrease outsourcing of data management services.

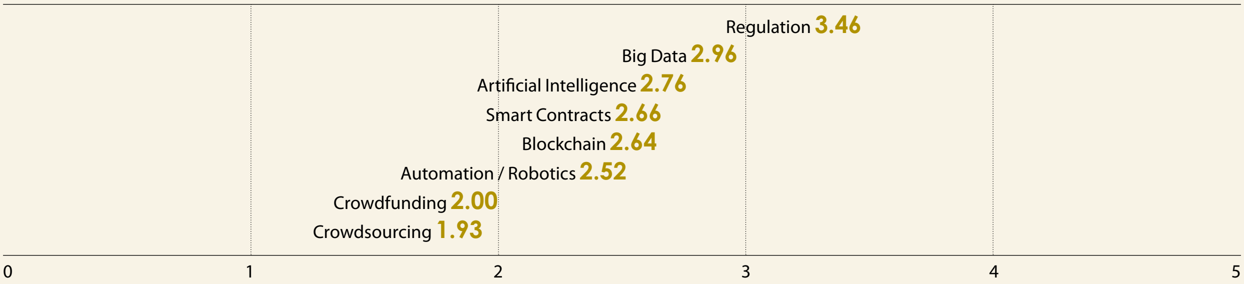
These findings marry with where private real estate fund managers see most potential for disruption to their business over the next three years: regulation, by a considerable margin, followed by big data and artificial intelligence.

How important are the following data management strategies to your firm (%)



Source: *PERE*

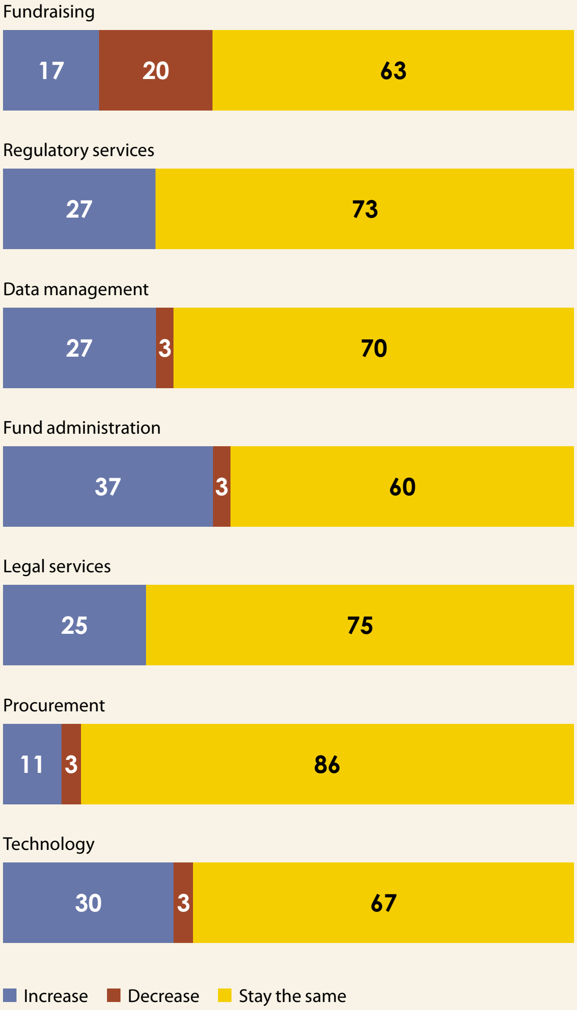
What is the potential of the following to disrupt the PERE investment and service space in the next three years?



1 - low potential, 5 - high potential

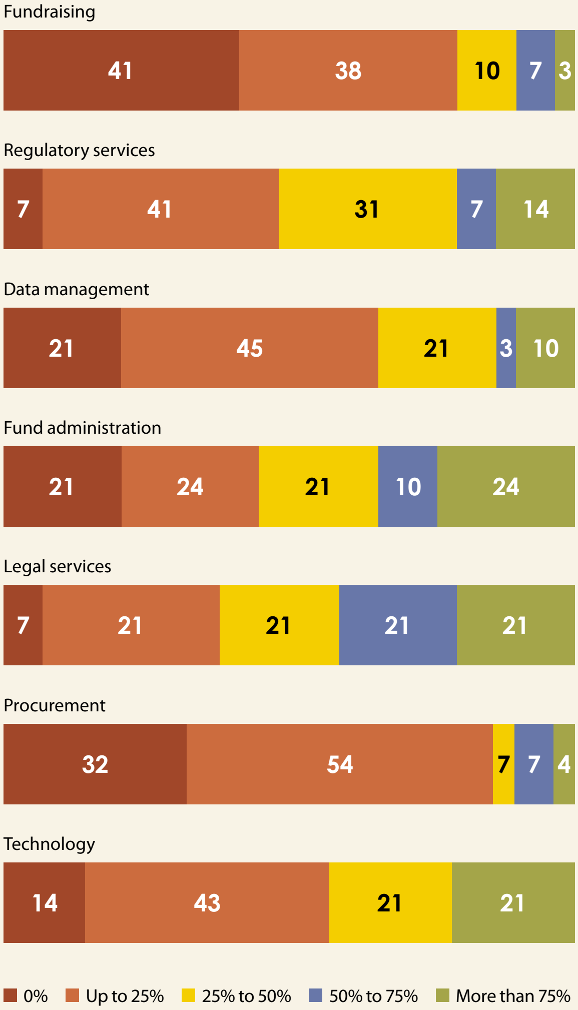
Source: *PERE*

How will you approach outsourcing of the following areas in 2018-19? (%)



Source: *PERE*

What is your target outsourcing level for the following areas? (%)



Source: *PERE*

Growth forecast is good

Expectations are conservative in the short term, but the long-term outlook is positive with particular optimism for Asia

Managers are upbeat about their long-term growth prospects, despite the increasingly disruptive regulatory and operating climate: 67 percent expect their real estate AUM to have increased by over 31 percent in five years' time; 79 percent forecast it will have increased by that amount in 10 years' time. Expectations are more measured in the short term, but growth is on the cards nevertheless: 44 percent of respondents are anticipating up to 11 percent AUM growth over the next year.

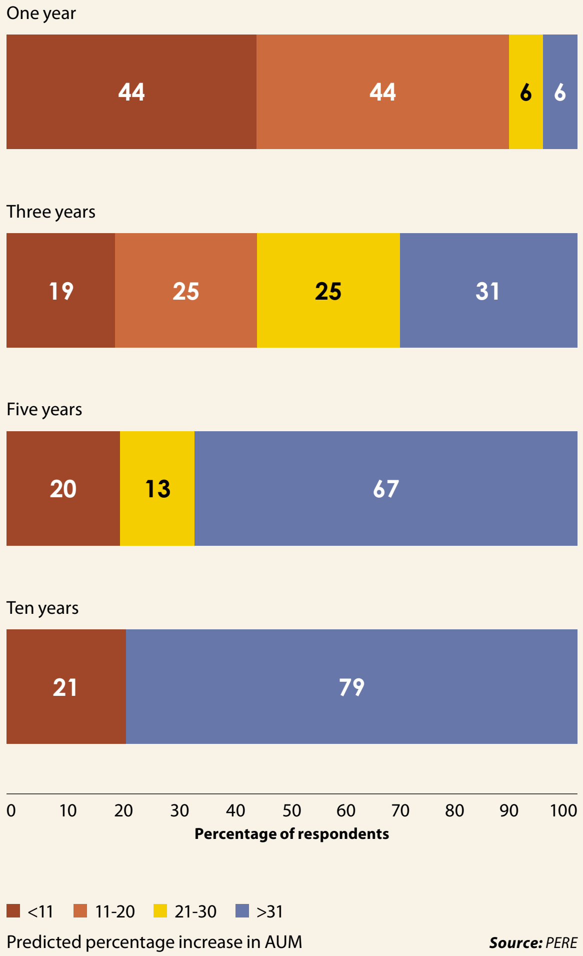
Respondents envision growth across their investor bases in the next five years. They are particularly bullish about expanding their pool of institutional investors: 40 percent expect to see a large increase in this cohort, compared with 28 percent and 13 percent for retail and corporate, respectively. Few anticipate their investor base will shrink.

Asia is expected to generate much of the expansion in funds' investor base, with almost half of respondents anticipating a large increase from the region in the next five years.

Methodology

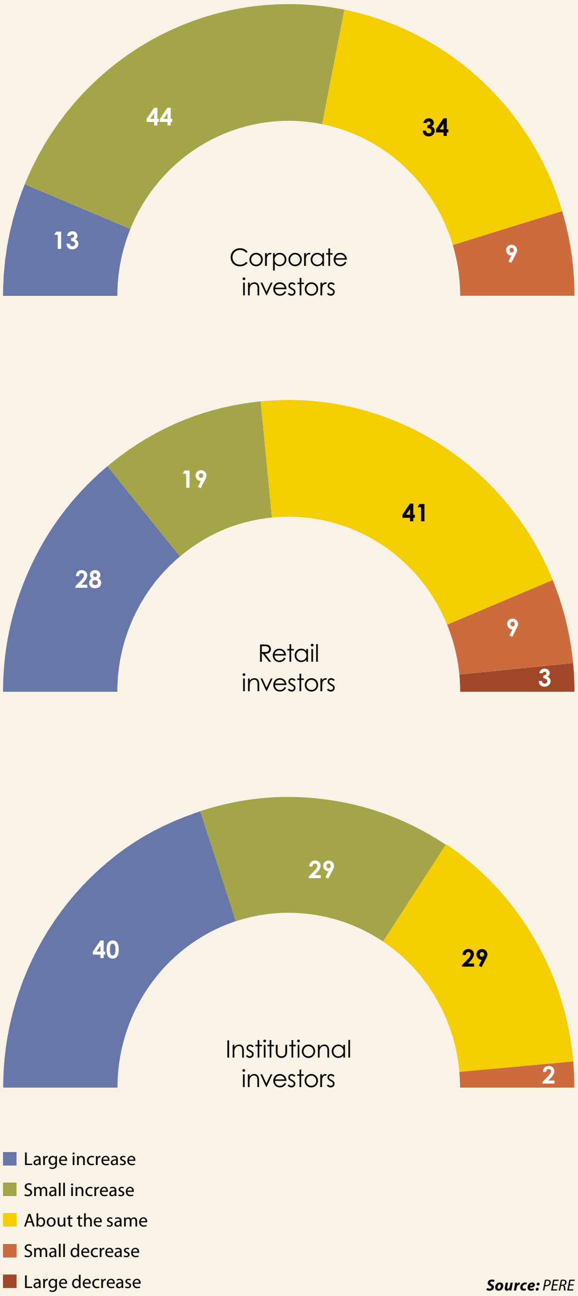
PERE surveyed the 75 largest private real estate managers. We received 51 responses: 31 are headquartered in North America 11 in Asia and nine in Europe. Answers were given on a strictly anonymous basis and the results aggregated. Where respondents were asked to give three answers, the first answer was given three points, the second two points and the third one point. An average was then taken of the total.

What is your growth forecast (based on % increase from now) for your private real estate AUM over:



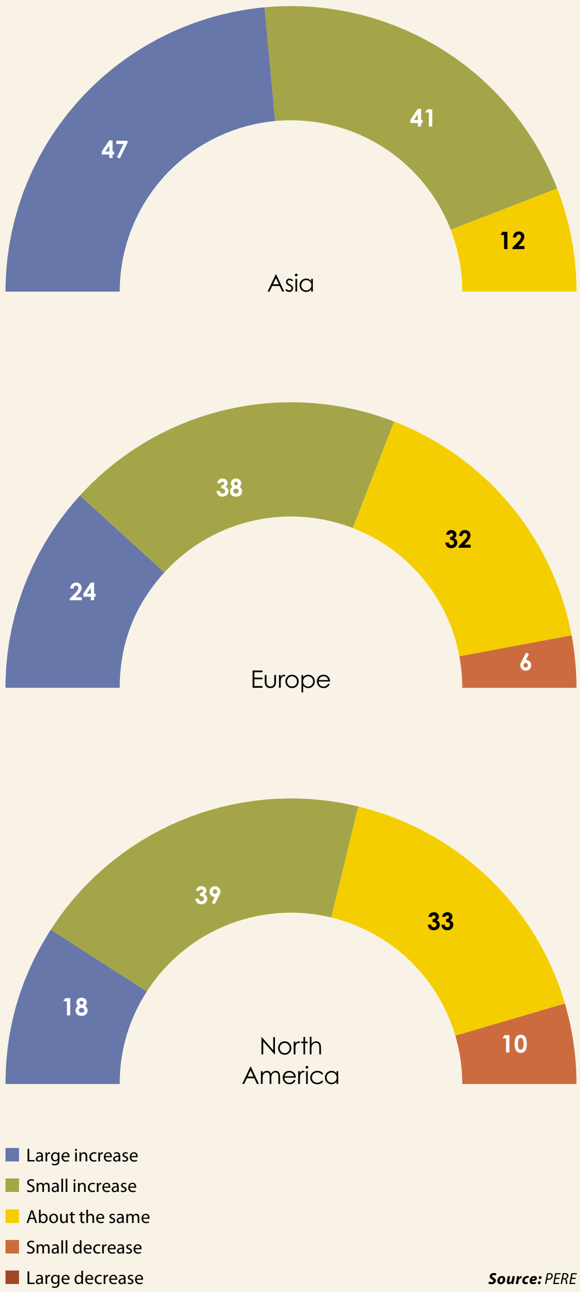
Source: *PERE*

How do you expect the proportion of your investor base to change in the next five years, by type of investor? (%)



Source: *PERE*

How do you expect the proportion of your investor base to change in the next five years, by location of investor? (%)



Source: *PERE*

Cayman Islands: a favorite destination for North America, Asia and Middle Eastern investors

Treasure islands

Dirk Holz, head of origination and business development for Private Capital Services at RBC Investor & Treasury Services, tells Stuart Watson how regulatory issues are influencing managers' choice of fund domiciles

The need to tap into increasingly globalized sources of capital is prompting more asset managers to create fund structures that comply with the European Union's Alternative Investment Fund Managers Directive. That tendency is boosting the popularity of fund domiciles such as Luxembourg and leading managers to outsource more of their fund administration functions, argues Dirk Holz, head of origination and business development for private capital services at RBC Investor & Treasury Services.

PERE: What are the leading domiciles for private equity real estate investment today?

Dirk Holz: For institutional capital there are two big hubs: Delaware, Cayman Islands and Bermuda for North American, Asian and Middle Eastern investors; or Luxembourg if managers want to attract European investment which goes into AIFMD-compliant structures. However, it is not usually a matter of one entity sitting in a single jurisdiction. A strategy may utilize five, or even more structures leveraged through different jurisdictions. For example, parallel structures that consist of non-AIFMD compliant funds based in Delaware, the Cayman Islands and Bermuda, and AIFMD-compliant funds that enable managers to access all kinds of global institutional investors in an efficient way. When choosing where their funds will be domiciled, asset managers have to look at where the properties are located and then structure the holding entities or feeders to provide tax-efficient up-streaming of the rental income or capital gains from sale proceeds. For that, Delaware, the Cayman Islands and Bermuda are still among the leading domiciles. They give a lot of flexibility from a structuring perspective and the regulatory burden is quite mild. Together they cover the majority of the global institutional money that flows into private capital strategies including real estate.

Five years ago, the majority of structures would have been domiciled in Delaware or the Cayman Islands. However, the introduction of AIFMD and other regulatory changes have driven a shift toward Luxembourg, but Delaware and the Cayman Islands will remain popular because two-thirds of the top global fundraisers in the real estate space continue to be US-based and they are still mainly raising US-based money.

Holz: AIFMD is driving businss to Luxembourg

PERE: How is regulation influencing domiciliation decisions?

DH: AIFMD has been a game-changer. If managers want to attract European money they have to create an AIFMD-compliant structure for the investment capital coming in. Usually that structure is not directly investing in the properties but investing in special purpose vehicles located where the assets are. For instance, if a European institution wants to invest in the US it may do so through a Luxembourg fund that invests into a Delaware structure, which then owns properties in the US.

Since the implementation of AIFMD in July 2013, the UK, Ireland and Luxembourg have emerged as the three leading jurisdictions covered by the regime. After the Brexit vote in 2016, a lot of asset managers questioned the UK as the right location for their fund management structures given the uncertainty over EU passporting rights. There is still an interesting angle for creating Irish-domiciled funds, especially if they are investing in domestic real estate through Qualifying Investor Alternative Investment Fund and Irish Collective Asset-management Vehicle structures. However, there is a clear trend emerging which favors Luxembourg at this stage.

We have observed a trend toward creating parallel structures in different jurisdictions. That is quite a smart way to operate if you want to attract European money, but you still have a lot of US or Middle Eastern investors. You set up a Delaware-Caymans structure together with a parallel fund that is AIFMD compliant and those two structures co-invest into the properties.

As of today, a lot of North American asset managers in the real estate space are not AIFMD compliant and are still doing distributions via the national private placement regime. However, in 2018-19 the European Commission will take a decision on whether to prolong NPPR or close down that option, so it may not be a long-term sustainable solution.

"There is a clear trend emerging which favors Luxembourg as a *PERE* fund hub. The majority of institutional funds launched in Europe are going into Luxembourg-based structures"
Dirk Holz

PERE: How are managers addressing the administrative burdens of operating across different jurisdictions?

DH: There is a strong connection between domiciliation, regulation and the drive towards outsourcing. The big private equity houses that manage their assets through the Cayman Islands, Delaware and Bermuda have more confidence their in-house teams can handle those domiciles, which are fairly straightforward in terms of regulation and require less reporting or regulatory follow-up.

Now, however, with the introduction of AIFMD-compliant funds they are tasked with additional reporting to the relevant regulatory bodies in Luxembourg, the UK or Ireland and need to set up a reporting function with specific local knowledge on the accounting side. There is a clear trend emerging among the US players entering EU jurisdictions to outsource the middle office and administrative component so they can focus on their core competencies.

This trend started for the European asset managers a few years ago following AIFMD implementation. What we're seeing now is those managers are asking whether they should outsource their accounting needs for Delaware, the Cayman Islands and Bermuda funds. For managers operating in both Europe and the US that means they can put their working capital into the investment side instead of spending it on running the administration, which as well as being a challenge isn't really a value-add activity for them.

PERE: Which jurisdictions are likely to gain popularity in the medium term?

DH: In the next five to 10 years it seems as though Luxembourg is extremely well positioned because of the regulatory regime. Over the last 12 to 18 months the biggest private equity fund managers have all set up management structures in Luxembourg and they are now starting to create AIFMD-compliant funds, most of them Reserved Alternative Investment Funds. Luxembourg also has a limited partnership regime, which is extremely flexible and very similar to those in the UK and US. Moreover, some big institutional investors, particularly pension funds and insurers, feel more comfortable investing in an AIFMD-compliant structure with greater regulatory oversight. It provides greater protection for their investors, even if the regulatory costs are a bit higher.

No one knows yet what will happen as a result of Brexit, and whether the UK will still have access through the AIFMD passporting regime to the European Union market, or if it will have its own regulations. Jersey and Guernsey are linked closely to the UK but they are independent from it, so they may be able to negotiate a separate third-party passporting regime into the European Union. If so, they could play a very important role especially for UK-based asset managers that want to raise money from outside the UK.

In Asia, there is a trend towards opening up fund structures in the real estate space to attract international investors. They will have to make this work from a regulatory and tax-efficiency perspective, but in five to 10 years there could be a market in some of the region's jurisdictions. □

Firming up foreign direct investment

The US government is poised to make sweeping changes to a committee that approves foreign investment, with major implications for real estate. By Meghan Morris

Two disparate pieces of real estate, New York's flagship Waldorf Astoria hotel and a rural wind farm, are examples of recent real asset deals that have attracted recent US government scrutiny for foreign buyers.

Now, the government is poised to keep an even closer eye on international buyers through legislation to strengthen the Committee on Foreign Investment in the United States, a program long used to mitigate national security concerns. Real estate in particular will feel the government's scrutiny, as a bipartisan bill explicitly adds the asset class to what the government can deem a national security risk.

"There are many areas where the government trend is toward deregulation," John Carlin, a partner at law firm Morrison & Foerster who previously oversaw the Justice Department's participation in CFIUS, tells *PERE*. "But this is an area where government scrutiny has been on a steady trend of increasing year over year. It's a new world when it comes to CFIUS."

From tanks to wind farms

Through executive order, President Gerald Ford founded CFIUS in 1975. What was then an executive panel focused on defense transactions such as companies that manufactured tanks and guns now encompasses 16 government bodies, including the Defense, Commerce and State Departments, and is chaired by the Secretary of the Treasury. CFIUS's definition of national security has also widened to an array of industries. A 2007 law, for example, designated 'critical infrastructure' as an area of concern after a Middle Eastern company took ownership of several US ports. Critical infrastructure has since expanded to include sectors such as the food industry and biomedical companies.

More recently, a major CFIUS theme concerning the real estate industry stemmed from the second-ever deal veto recommended by the agency. In 2012, a Chinese-controlled buyer sought to buy a wind farm without filing for CFIUS review. The committee asked to see the case and stopped the transaction, citing national security risk from proximity to a naval air station that tested stealth fighter planes – 50 miles away.

"Fifty miles is a long way," says Nicholas Spiliotes, who is co-head of Morrison & Foerster's national security practice. "The original reference point for proximity was 'line of sight,' but now, to be prudent, you have to look further than just a few miles away."

"With increased CFIUS scrutiny of real estate transactions, all of those things now become real considerations for US companies considering foreign investment"
Chris Brewster

Waldorf Astoria: NYC hotel deal questioned for security

After the Chinese company's appeal was vetoed by then-President Barack Obama, the company took the case to a federal court and settled the transaction confidentially. While the case's exact outcome was not announced, the process signaled that CFIUS would use a wide definition for proximity, also believed to be a factor in Blackstone halting the sale of San Diego's Hotel del Coronado in 2016 to Anbang because of its closeness to a major naval base.

Clarifying CFIUS

A clearer definition for proximity and other issues should come in pending legislation, industry observers say.

In November, a bipartisan group introduced the Foreign Investment Risk Review Modernization Act (FIRRMA) to codify some of what CFIUS is applying already, such as considering proximity to sensitive sites as a national security risk, and to add more stringent protocols to the review process.

"It's always hard to gauge how legislation will move, but when it comes to this particular bill, it does have strong bipartisan support in both the House and Senate," Carlin says. "It's clear the Trump administration is making a big push to get this out."

The bill is currently in hearings, and if it is not approved ahead of the fall election, the next window would be the lame duck session early next year. Real estate lobbying groups have so far remained quiet on FIRRMA, with a spokesman for the Real Estate Roundtable declining to comment for this story.

Chris Brewster, Washington, DC-based special counsel at law firm Stroock, tells *PERE* the final bill will change by the time it passes, but it will likely retain key provisions that target real estate transactions.

CFIUS historically has focused on mergers and acquisitions, but FIRRMA would extend the review to leases, which Brewster calls "unprecedented" and "hugely significant."

"The CFIUS review could be triggered, for example, if a government agency is located on the 10th floor and a foreign interest wants to lease the 9th floor," he says. "If you have an office building in which you have a lot of sensitive US government tenants, you may find you no longer have foreign or foreign-controlled prospective tenants interested in the building because they don't want to have to go through the cost and delay of CFIUS review."

$0

Current CFIUS filing fee

$300,000

or 1% transaction value

Proposed fee under new legislation

CFIUS has also become more concerned about foreign groups' access to communications. In the Waldorf transaction, for example, the committee was concerned that US presidents stayed at the property and that the US ambassador to the UN held residence there. Hotels in general can be a cause for concern because owners can access vast data troves of guest information.

"It remains to be seen how the industry moves toward smart technology," Carlin says. "To the extent that property owners and managers collect, or have the potential to collect, personal identifier data, CFIUS will be interested."

For the first time, FIRRMA adds filing fees to the CFIUS review: the lesser of $300,000 or 1 percent of the transaction value. FIRRMA also broadens CFIUS's mandate to transactions that do not involve a buyer taking a controlling stake in a company, but do involve the transfer of critical technology. If a foreigner invests in a technology firm and gains access to its intellectual property, for example, that deal could require CFIUS review.

Even under current law, CFIUS can look at the national security implications of any transaction that would result in foreign control of a US business, including real estate. CFIUS gives "control" a broad reading – including transactions in which minority investors have veto rights over business decisions, such as the appointment of key managers. Accordingly, Brewster recommends factoring a CFIUS review into the process for anyone evaluating foreign investment in a US business – especially if the acquisition involves property in close proximity to a key government installation – even if the transaction involves an investor from a country closely allied with the US.

He adds that the investor's foreign nationality is not the only concern. CFIUS will assess the investor's record of compliance with US laws and if its investment portfolio includes, for example, properties involving persons, entities or countries under US trade sanctions.

"Maybe it has a lot of Russian properties, or business partners, which can change the security profile," he says. "With increased CFIUS scrutiny of real estate transactions, all of those things now become real considerations for US companies considering foreign investment."

Despite all of those considerations, Brewster says US policy continues to favor foreign investment. Most transactions clear CFIUS review, although sometimes under terms designed to mitigate any national security risk.

Real estate comprised only 10 percent of all CFIUS reviews in 2015, the latest year for which public data is available. But with FIRRMA on the horizon, dismissing CFIUS as unrelated to real estate could put major deals in jeopardy.

Blackstone, which declined to comment, added FIRRMA to its business risks in its annual report filed with the Securities and Exchange Commission in March. The private equity giant noted the legislation "may reduce the number of potential buyers and limit the ability of our funds to realize value from certain existing and future investments."

However FIRRMA changes before it becomes law, the lawyers with whom *PERE* spoke agreed that for any deal involving foreign buyers, CFIUS must at least be a consideration on a standard M&A checklist. □

Hotel del Coronado: transaction stopped because of CFIUS concerns

Deluge: firms are overflowing with data

Too much information, or not enough?

Dirk Holz and Jamie Stevenson of RBC Investor & Treasury Services consider how real estate investors can better manage and interpret the reservoir of data they are accumulating. By Stuart Watson

Real estate investment managers now have significantly more information at their fingertips. But many are under-resourced when it comes to aggregating, assimilating and sometimes even understanding the data they have. Dirk Holz, head of origination and business development for private capital services, and Jamie Stevenson, managing director and global product head for data and analytics at RBC Investor & Treasury Services, discuss how the industry should tackle the big issue of big data.

***PERE**: Why is data gathering and analysis increasingly important for real estate investors?*

Jamie Stevenson: The use of new techniques such as machine learning and artificial intelligence support the creation of insights from vast amounts of structured and unstructured data. Institutional investors ultimately expect their investments to be managed in terms of returns and risk, and consequently asset managers are expected to ensure they respond to the rapidly changing landscape in which collecting and analyzing vast amounts of data is the norm. It is taken for granted that asset managers can drill down in increasing detail or provide more frequent and responsive insight.

Data and intelligent reporting and analytics will become one of the main, if not the main, differentiators for real estate managers in the future.

Dirk Holz: We are seeing a lot of new institutional investment money coming into real estate and private capital strategies that has traditionally been used for investing into liquid and listed assets. Those investors are accustomed to having daily valuations and a lot of details on the portfolio, which is something that real estate asset managers generally haven't provided. We are seeing a trend toward monthly, not quarterly, reporting and investors are requiring more data, even at a property level, as well as more analytics and benchmarking data. In the future we expect a significant increase in demand from institutional investors to receive value-added information out of the data that managers hold on their portfolios.

JS: Data management will increasingly be linked to services that create value out of investors' regulatory and performance data for reporting and analytics. Specialized service providers in the private capital space that already fulfil the role of depository and administrator have access to that data from investor to investment level and will be well-placed to exploit it. Data lakes and the use of advanced data analytics technologies are the most cost effective and viable options for gathering and analyzing data. The use of technologies such as Hadoop enable vast amounts of data to be captured and stored, which previous data warehouse solutions could not. Once data are captured there are many techniques for accessing relevant information, often supported by data engineers and data scientists. Presenting information in a dynamic and intuitive form also requires mastery of data visualization tools to highlight exceptions and trends to the less technically minded.

“Data and intelligent reporting and analytics will become one of the main, if not the main, differentiators for real estate managers in the future”
Jamie Stevenson

PERE: What is the most efficient way to tackle the data skills gap in real estate?

JS: The demand for data engineering and data science skills is high and the supply is limited. To add to the challenge, the ideal talent pool would have some background knowledge on the asset class or specifics at the property level. The difficulty of talent attraction and retention should not be underestimated, and it is not simply a matter of remuneration. The opportunity for talent to gain new experiences, “play” with new technology and put their skills to practical application in an environment that meets the candidates’ preferred lifestyle choices requires a cultural and mindset shift for potential employers.

DH: Deployment of resources could also be a challenge. Even if an asset manager was able to hire the right people, they would need to maintain them and keep them actively engaged all the time. But would that be the scenario if they reach a point in their business cycle when they are liquidating funds and not raising new ones? Then that becomes a challenge. Asset managers are beginning to realize the potential value in setting up systems to collect data, standardize it, and make something valuable out of it. However, the real estate and asset management business industry has been a little bit behind from an emerging technology and data perspective. Some of them are realizing that they will not be able to keep up with the constant evolution of all the technological changes globally, and so outsourcing makes much more sense.

JS: Data-as-a-service will see significant growth. Given the large investments that need to be made, it is inevitable that service providers will provide new technologies and services to clients in order for them to perform their own aggregation and analytics, or alternatively managers will outsource those functions to talent attracted to the scale that can be provided by the larger players. It’s about a partnering economy and having a focused business objective rather than simply developing data analytics expertise. In outsourcing data aggregation and analytics activities there will still be a requirement to ensure that the specialist real estate business knowledge and subject matter expertise is engaged with data analysts, who need to clean, transform and interpret data appropriately.

Stevenson: data skills are in demand

PERE: What uses can data analysis be put to within the real estate sector?

JS: There are really no limits to how a data scientist might attempt to provide insight, but having empathy with the client is the key. Consider the possibilities of an investor or an asset manager drilling down from the total investment and gaining deeper insights into the types of exposures within their portfolio. There are potential benefits at all levels of the investment chain – at investor, fund, asset and even property level – in areas such as risk and performance, fund distribution, management information to drive fund decisions, and efficient asset management.

Data analysis can provide the opportunity to gather news and social media sentiment then connect that into analytics about the factors impacting the demand for property. The ability to transform unstructured data, such as contracts and agreements, into key data points and then combine that information with the automation of tasks through robotics will generate opportunities to increase the efficiency of the administration and processing associated with real estate investments.

Blockchain and artificial intelligence should be seen as a positive disruptor to the industry. The evolving technologies have the potential to overhaul existing models and reduce the number of intermediaries or agencies within the value chain, speed up processes, and ultimately reduce cost. This will have the biggest impact for real estate around specialized innovations, such as how you deal with property management or title exchange. Take capturing data on the use and ownership of buildings, for example: historically that has been poor, but models are being created to make databases that are real-time and the quality of information much improved.

PERE: New technology also brings new risks. How should investors prepare for them?

JS: Investors and managers will need to be wary of ethical considerations regarding the use of data – you only have to look at the recent controversies surrounding Facebook and Google for an illustration of the dangers. Cybersecurity is also key, and with developments in quantum computing, which could create machines with the ability to crack currently unbreakable codes, it becomes even more important to stay focused on this threat. Maintaining strong data governance, ethical standards and a broad view across the global regulatory and political landscape are crucial, and not for the faint-hearted. □

A steady ship

Jersey is an oasis of calm and certainty in the choppy seas of European politics and regulation. By Helen Lewer

Operating in the current European cross-border fundraising and investment market can be a regulatory minefield for private real estate managers and investors, thanks to Brexit, AIFMD, and a host of other EU directives affecting the alternatives sector. Managers are looking to park their funds in a reliable domicile to mitigate any potential disruption, and Jersey is proving to be the location of choice for a growing number of them. Jersey Finance launched in 2001 to promote the jurisdiction as a center of excellence for business. The effort is paying off. A conversation between Mike Jones, Crestbridge, and Mike Byrne, PwC Channel Islands, reveals why this small island in the English Channel provides a compelling story for the sector.

Jones: managers can launch products quickly in Jersey

Brexit proof

Mike Jones: There is currently a lot of uncertainty because of Brexit, not only in the UK and Europe, but in the rest of the world. It is easy to forget the impact on a Singapore, Canadian or Swiss asset manager looking to market funds across Europe. But for Jersey it is also creating opportunities. Post-Brexit, the UK will not be as constrained by EU requirements and will be motivated to develop free trade agreements throughout the world. Jersey, being a crown dependency of the UK, is well placed to benefit from the new business this will bring. It is in prime position to offer managers access to the UK market. At the same time, Jersey is likely to maintain good access to Europe too.

Michael Byrne: I agree Brexit has caused uncertainty for the UK real estate market. But in Jersey itself, some of the largest private funds raised have come in the period since the referendum because Jersey is seen as a stable jurisdiction. Brexit has caused a lot of noise, but as an autonomous, self-determining country, Jersey is somewhat Brexit proof. The island is not a pawn in that particular political game. Those large funds (raised in the last few years) have huge teams doing due diligence, and assessing multiple jurisdictions before they decide where they are going to locate. Their choice of Jersey indicates it is viewed as a safe option for managers going forward. International assessments by organizations such as the International Monetary Fund and the Council of Europe back this up; they consistently rank Jersey at the top.

> **"NPPR can play an important role in offering UK managers continued access to Europe post-Brexit**
> **Mike Jones**

MJ: Market access will be a key issue for managers post-Brexit. The dynamics in Europe in terms of third-country equivalent assessments and third-country access will change. Europe will have to look closely at its third-country regime.

Byrne: Jersey is an easy place to do business

Managers need to think carefully about where they will domicile and market themselves going forward. Jersey's access to National Private Placement Regimes can play an important role in offering UK and other non-EU managers continued access to Europe and European managers access to the UK market. From the investor perspective, the regulatory climate presents challenges too. US-based funds and investors, for example, struggle with the European regime. Quite frankly, sometimes they are not bothering with Europe. That is a shame in terms of investor choice and investors in Europe being able to access the best managers around the world. Europe is viewed as too difficult, too costly. The NPPR allows managers to market to two or three jurisdictions in a more effective and cost efficient manner, and to avoid a pan-European marketing effort.

Business continuity post-AIFMD

MB: Initially, the directive was badly received by mangers and investors, but it would have been more difficult to work with had it not been for the UK's involvement under Lord Hill. This is not going to be the case with the forthcoming review of the Directive and shaping of AIFMD II. Several industry bodies, and also the EU Commission, have already surveyed the industry to gauge sentiments and concerns around AIFMD II. There is a perceived danger of the EU shutting off distribution of non-EU funds into Europe. It cannot afford to get this wrong. Investors want free choice and access to the best managers in the world. The EU must avoid creating inappropriate barriers to access.

"The EU must avoid creating inappropriate barriers to access"
Mike Byrne

MJ: The impact of AIFMD on Jersey itself has not been too dramatic. Looking back over the last five years, NAV in Jersey is up about $100 billion. Through NPPR there are around 150 managers marketing about 300 funds into Europe. Those stats are going up every quarter. Jersey has done everything to ensure business continues smoothly for managers and investors post-AIFMD in terms of securing market access. Jersey has proven time and time again that it can negotiate effectively with relevant EU authorities; it did this well under AIFMD I. I expect Jersey to continue lobbying for the same security and market access for managers under AIFMD II.

149

AIFMs are authorized to market into Europe through Jersey's NPPR as of December 2017

17%

Increase from December 2016, according to Jersey Financial Services Commission

Five reasons to domicile in Jersey

- ✓ High regulatory standards
- ✓ Market flexibility
- ✓ Funds are authorized and launched quickly
- ✓ Political and economic stability
- ✓ Access to highly skilled financial services professionals

A secure anchor

MJ: Jersey's regulatory standards are a key reason why it is now one of the most favored fund domiciles. It offers proportionate responses to difficult issues. This is an important differentiator. Managers are getting flexibility but with very high standards. Couple this with speed to market. Managers can get their products authorized and launched incredibly quickly, knowing they are not going to sit with the regulator for six months. That is a huge benefit from my perspective.

MB: Those are all good reasons for locating in Jersey, but I would add product choice as to why it is seen as a safe bet for real estate fund managers. The jurisdiction offers a range of products and structures to suit every situation. Then there are soft factors. The jurisdiction has had a finance industry for 40 years. The professionals working there are true experts; highly qualified and trained. And Jersey is an easy place to do business. When we think about some other jurisdictions in Europe, it is hard to get straight answers or to achieve quick turnarounds; they sometimes lack a can-do approach. Jersey, by contrast, is very client-centric. The culture is just right.

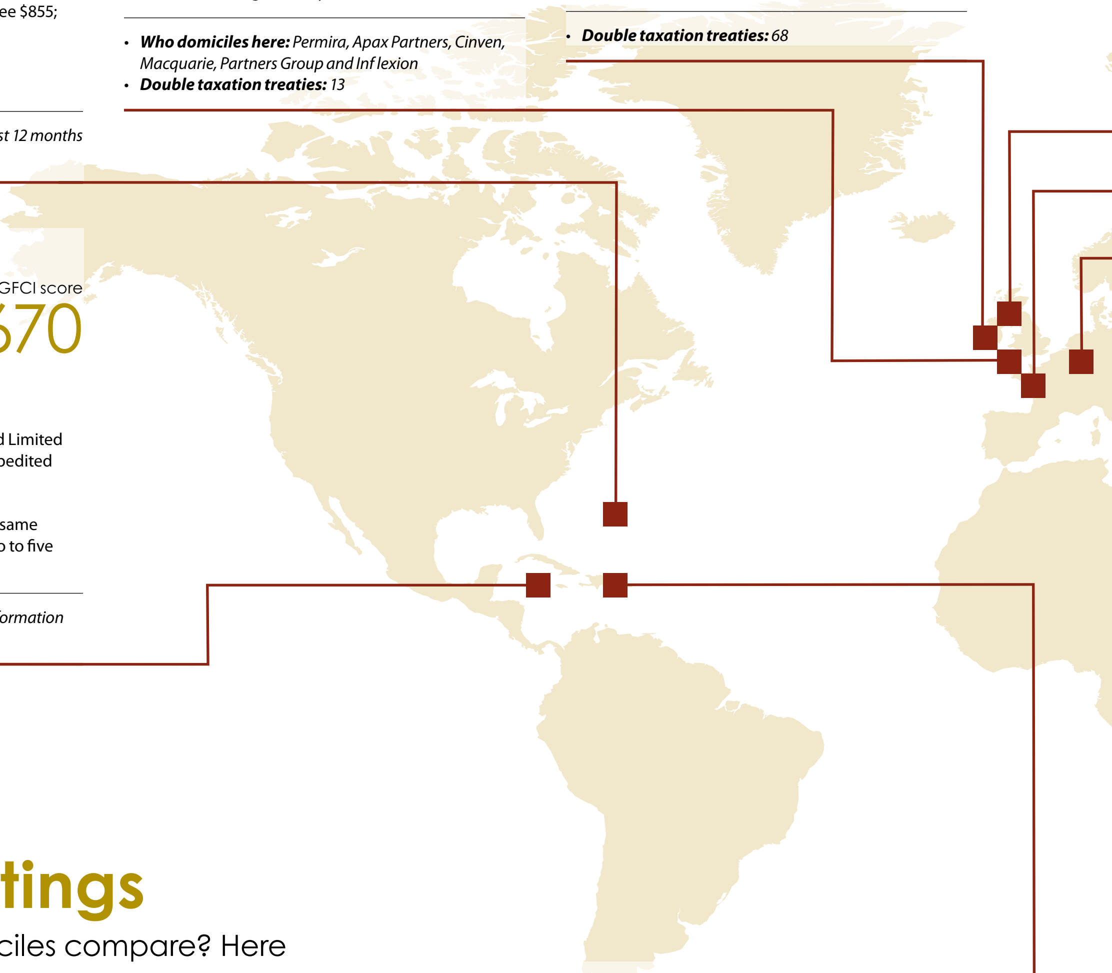
MJ: We should also not ignore the political and economic stability Jersey offers as a reason for managers domiciling there. If you look around the world, there is little of that these days. Despite its small landmass, Jersey is a jurisdiction of substance with over 13,000 employed in the finance industry; not the perception many people have of an offshore center.

MB: PWC recently forecast that global AUM will increase 70 percent by 2025 and that alternative assets will grow from $10 trillion to $21 trillion over the same period. In terms of real estate, we are seeing more people moving to cities, and a pressing need to replace existing stock. There is more investor appetite for real estate. That is great news for Jersey, which is well placed to share in the opportunities this growth will bring. Jersey is innovating new products and services to make sure it remains relevant to that growth. □

Regime ratings

How do different domiciles compare? Here are the rankings for some of the industry's most popular and developing fund domiciles, according to the Global Financial Centres Index, which looks at the competitiveness of the world's major financial centers on a scale of 1,000 points. Factors include the availability of skilled personnel, the regulatory regime and the ICT infrastructure. By Rebecca Akrofie

Regulatory body | Regulatory fees | Time to set up a fund



GUERNSEY

GFCI ranking **47** GFCI score **629**

- Regulatory body: Guernsey Financial Services Commission
- Regulatory fees: Application fee £3,335 ($4,312; €3,932); annual fee: £3,335
- Time to set up a fund: One or three days for fast-track fund; non-fast track averages 28 days

- ***Who domiciles here:*** *Permira, Apax Partners, Cinven, Macquarie, Partners Group and Inflexion*
- ***Double taxation treaties:*** *13*

IRELAND

GFCI ranking **33** GFCI score **663**

- Regulatory body: Central Bank of Ireland
- Regulatory fees: None for passport of supervision; authorized funds pay minimum levy of €1,700
- Time to set up a fund: Typically six to eight weeks

- ***Double taxation treaties:*** *68*

BERMUDA

GFCI ranking **34** GFCI score **660**

- Regulatory body: Bermuda Monetary Authority
- Regulatory fees: Application fee $855; reclassification fee $855; annual fee $968-$1,535
- Time to set up a fund: Same day for private funds

- ***Funds domiciled:*** *64 funds established in last 12 months*
- ***Double taxation treaties:*** *41*

CAYMAN ISLANDS

GFCI ranking **31** GFCI score **670**

- Regulatory body: Cayman Islands Monetary Authority
- Regulatory fees: Initial registration fee for an Exempted Limited Partnership is $1,215, plus $486 for expedited registration. Annual fees are $1,458
- Time to set up a fund: ELP and GP registration take place on same day, with certificates issued within two to five working days

- ***Double taxation treaties:*** *35 signed Tax Information Exchange Agreements*

BRITISH VIRGIN ISLANDS

GFCI ranking **51** GFCI score **625**

- Regulatory body: British Virgin Islands Financial Services Commission
- Regulatory fees: Application fee $700; annual fee $1,000
- Time to set up a fund: Around four to six weeks depending on complexity and service provider requirements

- ***Double taxation treaties:*** *23*

ISLE OF MAN

GFCI ranking **58** GFCI score 617

- Financial Supervision Commission
- Varies depending on type. Application fee ranges from zero to £2,850 ($3,685; €3,360)
- FSC must be notified within 10 business days of launch of a qualifying fund or a specialist fund. Average time is two to four weeks for typical fund; two to three months for regulated fund; two to six months for an authorized scheme

- ***Double taxation treaties:*** *24*

JERSEY

GFCI ranking **43** GFCI score 633

- Jersey Financial Services Commission
- For a standard Jersey private fund: £1,070 ($1,290; €1,180) set up fee; £500 annual fee. Other funds: Fee differs depending on fund, typically a set-up fee of £1,820 and £4,000-£10,000 annual fee.
- 0-30 working days.

- ***Who domiciles here:*** *30 funds in the last 12 months*
- ***Double taxation treaties:*** *25*

LUXEMBOURG

GFCI ranking **18** GFCI score 708

- Commission de Surveillance du Secteur Financier (CSSF)
- Initial fee from €3,500 to €7,000; annual fees from €3,000 to €30,000 depending on sub-funds.
- Between a few weeks and several months depending on structure.

- ***Who domiciles here:*** *EQT*
- ***Double taxation treaties:*** *80*

MALTA

GFCI ranking **77** GFCI score 594

- Malta Financial Services Authority
- EU AIFMs: Application fee €1,250, annual fee €4,000; Non-EU AIFMs: Application fee €2,500, sub funds €450, annual fee €3,000 (€500 for sub funds)
- Up to three months for authorization as an AIFM; for Professional Investor Funds, applications are reviewed within seven business days

- ***Double taxation treaties:*** *72*

HONG KONG

GFCI ranking **4** GFCI score 755

- Securities and Futures Commission and Mandatory Provident Funds Authority
- Annual fees HK$6,000 ($770; €707); umbrella fund HK$7,500; sub fund HK$4,500
- "Take-up letter" generally issued within two business days

- ***Double taxation treaties:*** *61*

SINGAPORE

GFCI ranking **3** GFCI score 760

- Monetary Authority of Singapore
- Varies depending on legal structure of the fund
- Between three and four months for authorized and recognized funds, depending on complexity

- ***Funds domiciled:*** *64 funds established in last 12 months*
- ***Double taxation treaties:*** *41*

MAURITIUS

GFCI ranking **71** GFCI score 603

- Financial Services Commission
- Registration fee $1,000 plus $2,500 annually; additional funds $3,000 and $500 annually
- No prescribed time

- ***Who domiciles here:*** *includes Inventus Capital Partners Fund III; AFIG Fund II LP and Pravega Fund I*
- ***Double taxation treaties:*** *43*

Beijing's heavy hand: China's central bank has kept its grip on controlling capital outflows

Closing loopholes

China's latest dictum on outbound investments has brought even offshore Chinese entities into its regulatory purview, but a lack of clarity is creating confusion. By Arshiya Khullar

Two years in, and the regulatory scrutiny on cross-border Chinese institutions is only intensifying.

Last month, authorities in China expanded their surveillance to bring into their purview one of the most popular circumvention routes used by mainland Chinese companies of late to invest overseas: via their offshore subsidiaries. Starting March 1, the offshore subsidiaries of all Chinese investors, including financial enterprises and individuals, need the approval of The National Development and Reform Commission (NDRC), China's state planner, before closing any overseas transaction.

In case the deal is what NDRC calls a 'non-sensitive' project, only a filing is to be made if the investment amount exceeds $300 million. But for 'sensitive projects,' irrespective of the size, a filing alone is not sufficient and companies need to obtain an approval. Additionally, the NDRC Order 11 also applies to Chinese firms sponsoring or investing in an offshore private equity investment fund, which was not under the regulatory ambit until now.

Chinese insurance companies and other financial institutions have increasingly been using their Hong Kong subsidiaries' balance sheets to fund acquisitions, either in entirety or to meet the initial deposit obligation until the State Administration of Foreign Exchange (SAFE) approves their foreign currency conversion. One example was China Life Insurance's $350 million acquisition of a single-tenant property portfolio from US manager ElmTree last May. China Life used its offshore investment arm in Hong Kong to pay for the deal, a company spokesperson had earlier confirmed to *PERE*.

In theory, these latest requirements are just additions to an already existing list of items Chinese investors need to check off before they sign a non-binding agreement. However, as things currently stand, several cross-border investors, their advisors and legal experts have told *PERE* they are confused and uncertain about how this circular should be interpreted.

Until the NDRC issues further guidance or until market participants have had more experience dealing with the regulators, investors will be "crossing the river by feeling the stones," law firm Morrison & Foerster said in a note published in March.

"We are advising clients to take a conservative view and go to the NDRC to ask for approvals for every deal"
Paul Guan

The biggest unanswered question is what the regulators deem as a sensitive sector. While real estate and hospitality come under what has been termed as a 'restricted sector,' there is ambiguity about their definitions. For example, what if an investor is looking to acquire an operating platform such as an asset-light hotel management company instead of a hotel asset – is that to be considered sensitive? That is one question asked by Paul Guan, partner at global law firm Paul Hastings.

"We are advising clients to take a conservative view and go to the NDRC to ask for approvals for every deal. Instead of trying to circumvent rules, it is better to talk to regulators," he says.

"Even if one is following the books right now to remit money overseas, banks are asking more questions and the transfer process is slower than it used to be"
Richard Yue

Even though the official filing process is simple, the outcome takes time. Institutions are required to file for an approval through an online application system, and it takes 20 business days for a decision to be made. In the case of a complicated deal that involves other Chinese regulatory bodies, the waiting period increases to 70 days.

There are also times when the investor neither gets a rejection nor an approval, in which case it may feel emboldened to take the risk and sign a deal, landing in regulatory trouble much later, a Beijing-based real estate investment manager told *PERE*.

Adding to the confusion is the number of regulatory bodies in China involved in these approval processes. SAFE is responsible for granting foreign currency quotas, in liaison with the Ministry of Commerce. The insurance investor community also has the China Insurance Regulatory Commission acting as a watchdog.

"There was always an issue with NDRC trying to grab the power to control foreign investments," explains one Shanghai-based lawyer. "Investors were always confused about whether to go to NDRC first or to SAFE to approve its capital conversion. With Notice 11, it is clear that SAFE is not allowed to process any capital conversion unless the firm has obtained clearance from NDRC."

Deployment and exits at stake

What started off as government-led measures to stem capital outflows and prevent a reckless depletion of China's foreign reserves have widened in scope over the past two years to reign in speculative overseas deals by highly-leveraged domestic conglomerates.

This has materially impacted the volume of Chinese cross-border investments. There was a staggering 75 percent drop in mainland Chinese capital deployed in US real estate deals in 2017, according to research by Cushman & Wakefield. From $18.3 billion worth of Chinese investments into the US in 2016, last year saw only $4.5 billion. Furthermore, the real estate consultancy expects outbound activity to cool by 30-40 percent this year, according to its Chinese investor intentions survey published in February.

"Nobody wants to be out there right now making a headline," says Priyaranjan Kumar, regional executive director for capital markets at Cushman & Wakefield. "The next three quarters, at least, we are not expecting Chinese investors to bid for pure real estate assets."

It is not just outbound deals that are stuck in limbo. Managers selling assets in mainland China are facing more scrutiny by local banks for remitting capital. Several managers use an offshore holding structure in Hong Kong or elsewhere to invest capital from their funds into China. The proceeds from the sale then need to be converted into US dollars or other currencies. One manager that runs a pan-Asia real estate fund told *PERE* that around 400 million yuan from one of its exits has been stuck in an onshore bank for two months and there is still no word on when it will be transferred.

Hong Kong-headquartered investment manager Arch Capital Management has had similar experiences.

"Even if one is following the books right now to remit money overseas, banks are asking more questions and the transfer process is slower than it used to be," says Richard Yue, chief executive and co-founder at Arch Capital Management. "The banks want to make sure there is no hidden entity behind the receiving party."

In one instance, it took Arch Capital Management over the year-end and Chinese New Year holidays to complete an exit because of the time taken by the Chinese bank to arrange the transfer.

But despite the lengthy process, the firm continues to have a strong pipeline of potential investment opportunities in China. Yue feels the fundamentals of the underlying property market in China are attractive and tighter controls in the country's financial system are better for the stability of market in the long run. But for now he suggests managers factor in

HNA's selling spree

From an aggressive buyer, Chinese regulatory scrutiny on HNA and its financial health has prompted a raft of sales overseas

Date	Asset Disposal (as of Feb 2018)	City	Price
Jan 2018	Colonial House	Sydney	$159m
Feb 2018	Commercial Lands NKIL6562 & 6565	Hong Kong	$2.04bn
Feb 2018	1180 Avenue of The Americas	New York	$305m
Feb 2018	19-21 East 64th Street	New York	$90m

Source: *JLL and Real Capital Analytics* potentially lengthier transfers in their underwriting as a consequence of these capital controls.

Opportunity in distress

Even though these curbs are expected to continue, some industry observers insist there is no blanket ban on all overseas deals and certain kinds of transactions are still being approved, even encouraged.

"Long-term investments in the senior housing sector are being encouraged by the government," Allan He, senior partner at Beijing-headquartered investment manager Cindat Capital Management, said at *PERE*'s annual summit in Asia in March. "This is because they recognize that this is an opportunity for investors to enjoy a stable cashflow and also put the operational expertise and operating models to use back in China."

He said that the firm has been actively pursuing senior housing and healthcare deals over the past six months. Indeed, according to a *Bloomberg* article, the firm is planning to spend $2 billion this year on homes for the elderly in the US. "On the surface, one is seeing regulation and a lot of control," he said at the *PERE* conference in response to a question on how capital controls have impacted its pace of outbound deals. "But, so far, our investor base has not been much affected because they already have dollars in offshore banks."

Logistics is another sector that some say is being encouraged for strategic reasons, if the investment falls in line with China's ambitious 65-nation Belt and Road initiative. China's own state fund China Investment Corporation, for instance, was behind one of the biggest European logistics deals last year when it paid €12.25 billion to acquire Blackstone's pan-European logistics platform, Logicor.

2016: $18.3bn

2017: $4.5bn

Chinese real estate investments into the US, according to Cushman & Wakefield data

As the regional head of a large global institutional investor pointed out to *PERE*, this is a major reason why "almost everyone is trying to peg on the Belt and Road initiative to get regulatory approvals."

Chinese investors' run-ins with their authorities is also creating potential buying opportunities for Western managers. One of China's most acquisitive investors, HNA Group, has reversed its ambitious buying spree and has been actively trimming its portfolio. According to Real Capital Analytics, the group has disposed of around $5.5 billion of overseas real estate and hotel company stakes since the start of this year. Such deals will open the door for private credit lenders like the New York-based Mack Real Estate Credit Strategies to provide debt capital to opportunistic investors bidding for assets.

However, Peter Sotoloff, managing partner and chief investment officer at the firm, does not believe these exits will all be distressed in nature. "They [Chinese firms] are so far being thoughtful in how they are monetizing these assets. Except for the development sites that have a higher execution risk, these sales are not creating a windfall of distressed real estate opportunities," he says.

China's crackdown on outbound deals comes at a momentous time for the country. Last month, its congress passed a major constitutional amendment allowing for the removal of presidential term limits. This means that President Xi Jinping, whose tenure was set to expire in 2022, could remain president for life. This news was followed by the nomination of Yi Gang as the country's new central bank governor.

President Xi has already made a public resolution to tackle financial risks arising from overleveraged institutions. Until this stance shifts, Chinese cross-border investors should be prepared to face a bumpy ride. □

Widening the net

The latest requirements from by the National Development and Reform Commission (NDRC) oblige offshore entities to file for approvals for overseas deals

Type of investment project	Investment amount by Chinese investors	Investment by a Chinese investor located within China directly		Investment Indirectly via an offshore entity controlled by a Chinese investor located within China
		Central Enterprise	Non-Central Enterprise	
Sensitive Project	Any amount	NDRC approval		NDRC approval
Non-sensitive Project	Equal or more than $300m	NDRC filing		Report to NDRC
	Less than $300m	NDRC filing	NDRC provincial filing	No pre-investment approval, filing or report required

Source: *Paul Hastings*