



INTERNATIONAL INVESTMENT AND REGULATIONS INFLUENCING THE DOMESTIC REAL ESTATE MARKET

iGLOBAL 14TH REAL ESTATE PRIVATE EQUITY SUMMIT

MARCH 2016

International Investment in U.S. CRE



Foreign investor demand for U.S. commercial real estate has continued to increase amid low global yields, a relatively stable U.S. economy and ongoing regulatory changes in EB-5 and FIRPTA

Key Trends in Foreign Investment in U.S. Commercial Real Estate

- Central bank intervention and low global yields for traditional fixed income investments have driven increasing foreign demand for U.S. commercial real estate
- A relatively stable U.S. economy and expectations of continued dollar strength have also led to increased interest from overseas investors who frequently view U.S. commercial real estate as a safe haven
- However, continued currency appreciation could create headwinds by increasing the cost of U.S. real estate for foreign investors and raising concerns of a future shift towards depreciation
- Low energy costs are also a concern given the importance of energy-rich nations and sovereign wealth funds to U.S. CRE

FIRPTA Revisions could Provide a Further Boost for Foreign Demand in U.S. CRE

- FIRPTA changes could lead to greater incremental demand, due to reduced tax drag for certain U.S. CRE investment types and certain foreign investors
- Importantly, recent FIRPTA reforms have increased the foreign ownership limit from 5% to 10% for publicly traded REITs and allowed foreign pension funds to be exempt from FIRPTA

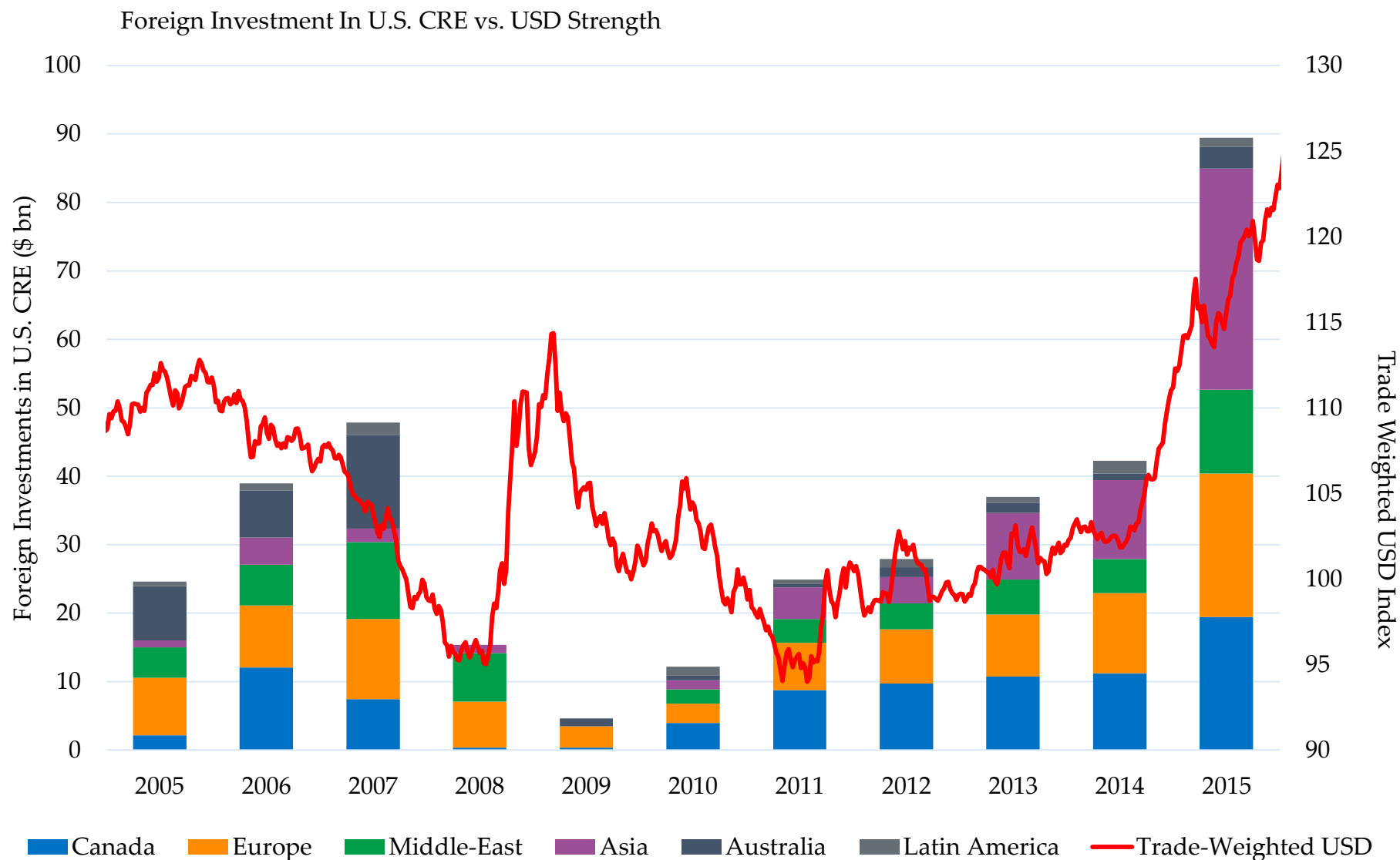
EB-5 Program Granted Temporary Extension although Headwinds Remain

- Temporary renewal of the EB-5 program through September 2016 provides an opportunity for developers, as proposed changes included higher minimum investments and greater restrictions on Targeted Employment Areas
- However, developers will need be mindful of potential future difficulties arising from EB-5 retrogression, which is expected to cause a protracted, multi-year delay for Mainland Chinese applicants
- Increased regulatory oversight may also create challenges for capital raising

Strong Dollar and Real Estate Values



Strong U.S. dollar has historically been correlated with increased foreign investment in U.S. CRE, due to its status as a safe haven, favorable economic growth and expectations of continued appreciation



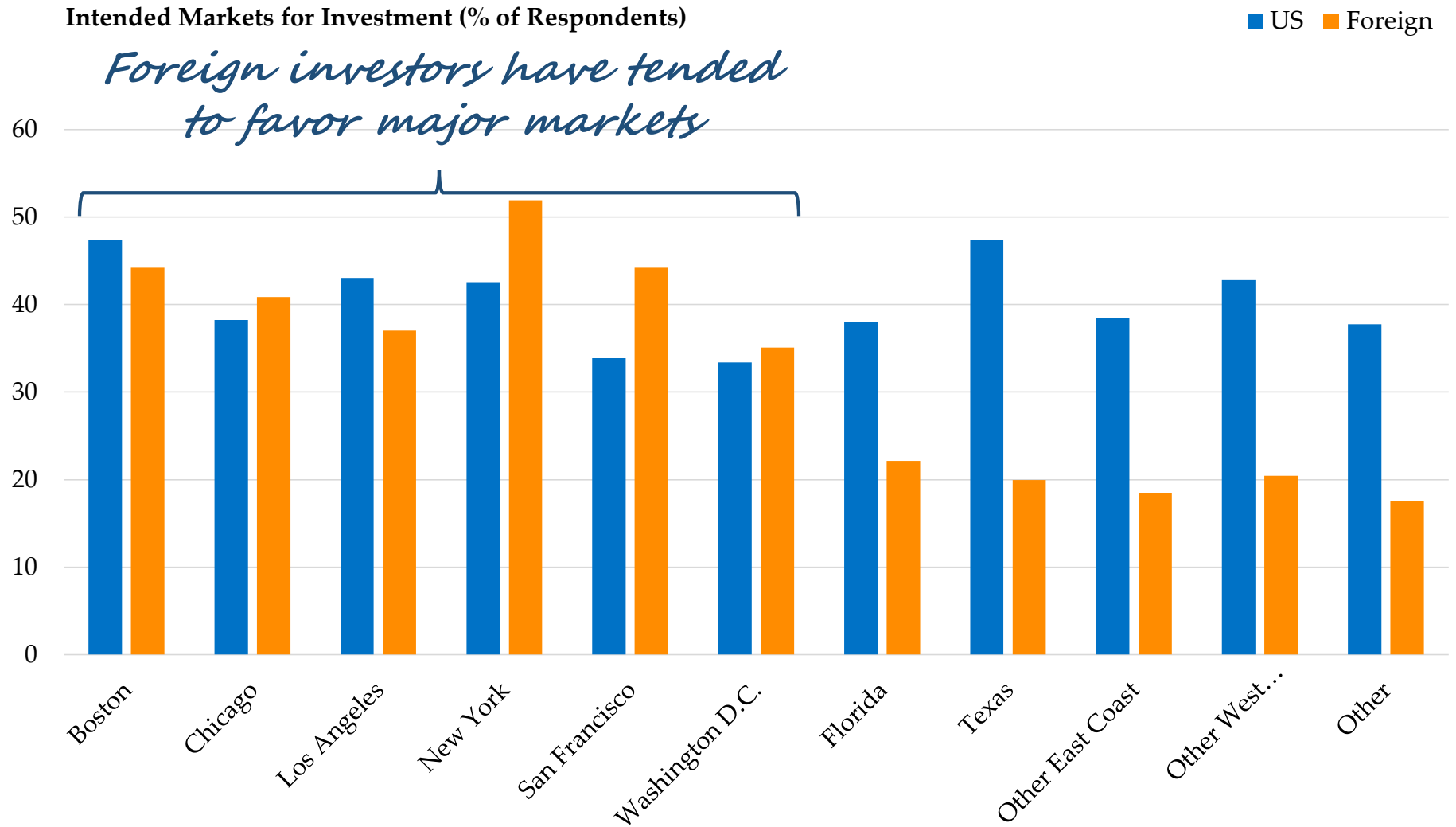
Source: HFF, Morgan Stanley, Federal Reserve, RCA

Foreign Investors have Flooded into Major Markets



Foreign investors frequently view U.S. CRE as a safe haven and capital has flooded into major markets and trophy assets, which were deemed to be the safest investments

Foreign Buyer Share of US CRE and Bifurcation by Market



Source: CBRE, RCA, Morgan Stanley Research

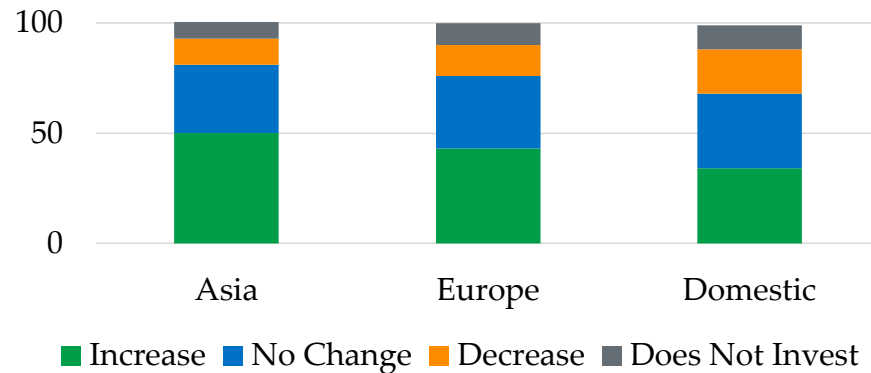
Foreign Investor Demand Expected to Grow Further



Demand for U.S. CRE from foreign investors, particularly Asian-domiciled buyers, is expected to grow

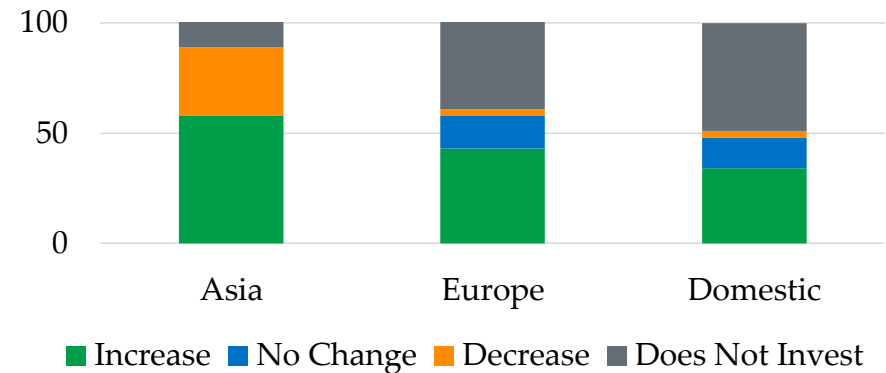
Growing Allocations to Non-Listed U.S. CRE Funds

Changes to Non-Listed Funds (% of Investors)



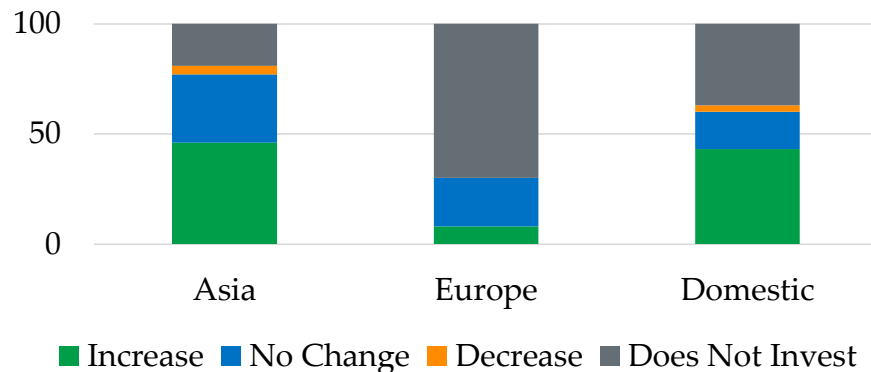
Growing Allocations to U.S. CRE Joint Ventures

Changes to Joint Ventures (% of Investors)



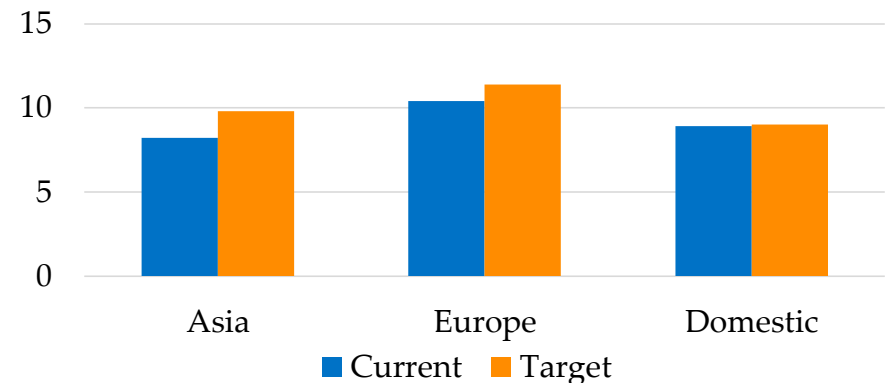
Growing Allocations to U.S. CRE Direct Investments

Changes to Direct Investments (% of Investors)



Current Allocations Below Targets

Current and Target Allocations (%)

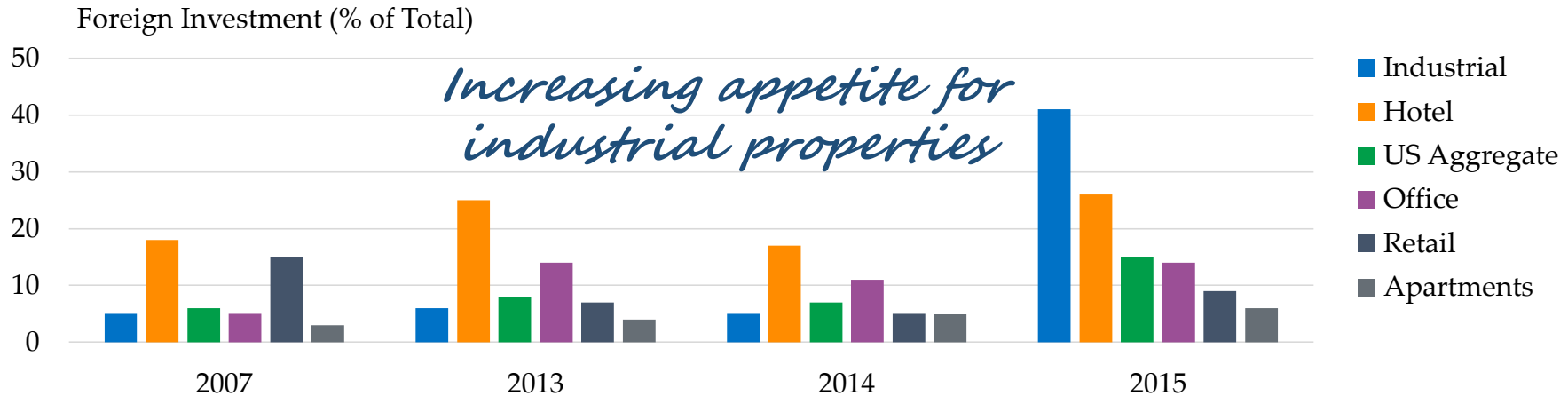


Foreign Buyers also Beginning to Expand their Opportunity Set

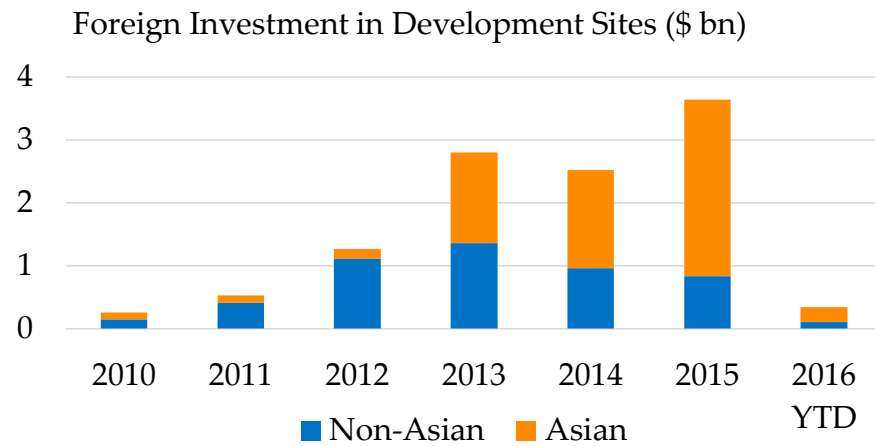


Foreign investors in U.S. CRE have begun to gradually shift their investment focus, as prices for apartment and office properties in gateway cities have easily surpassed previous peaks

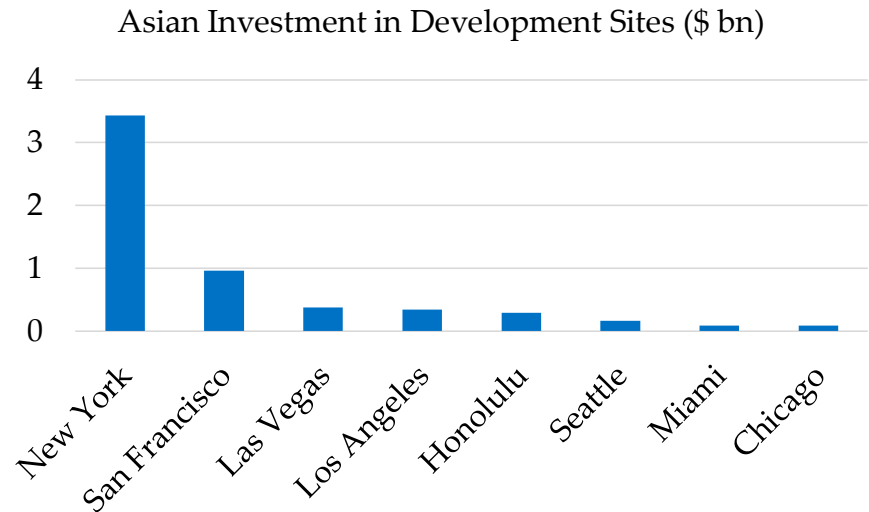
Foreign Investments by Property Type



Foreign Development Activity has also Improved...



...But the Shift Away from Core Markets is Gradual



Source: CBRE, RCA

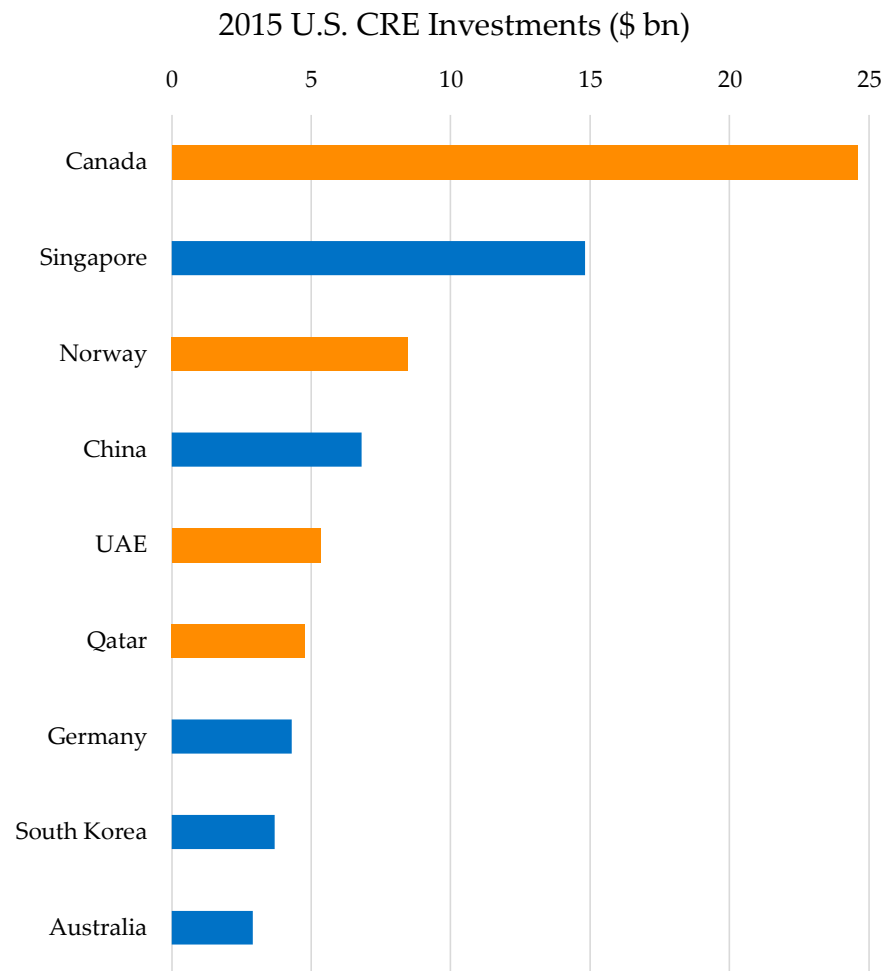
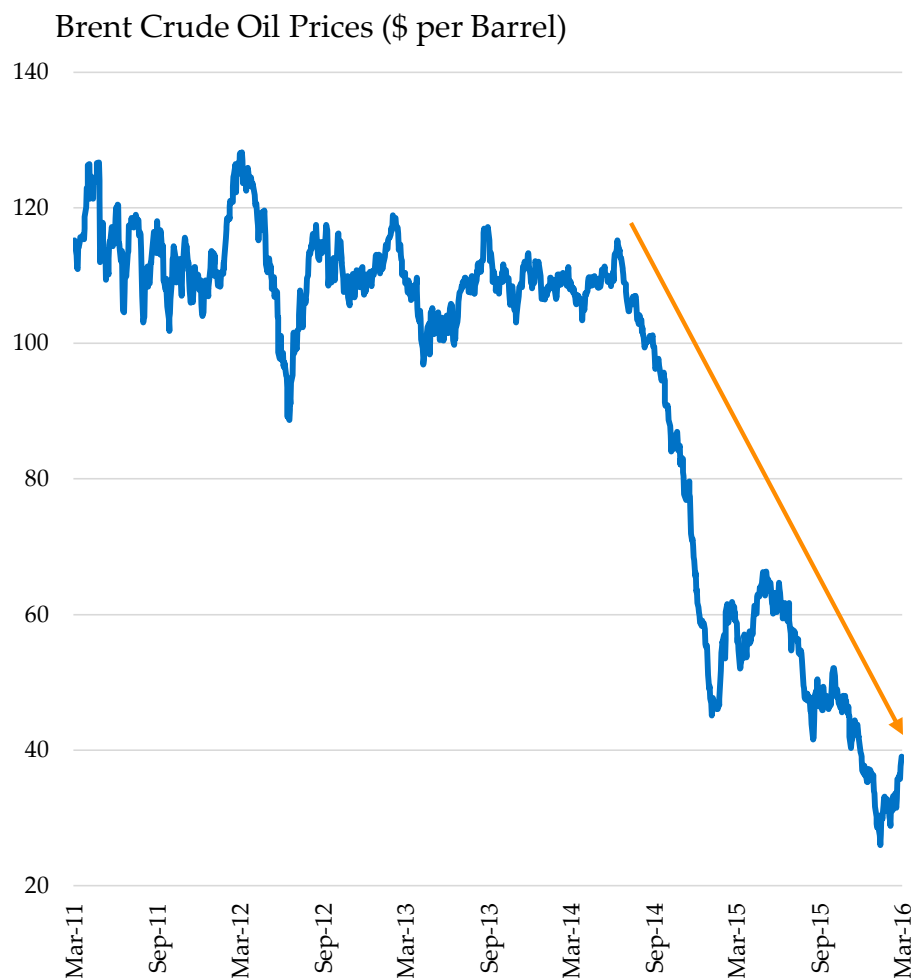
Energy Prices Create Headwinds for Sovereign Wealth Funds



Sovereign wealth funds (SWF) from energy-rich nations have been among the most active foreign investors in U.S. CRE. Declining energy revenues could force SWFs to reduce investments or potentially sell holdings

Energy Prices have Collapsed

Energy Rich Nations have been Major U.S. CRE Investors



Source: Morgan Stanley, Federal Reserve, RCA

FIRPTA Reform and Expected Impact



Cross-border partial-interest acquisition activity has increased significantly, with the prevalence of foreign investors acquiring partial interests rising from its 2005-2007 average of 14% to over 27%

Summary of Key FIRPTA Changes

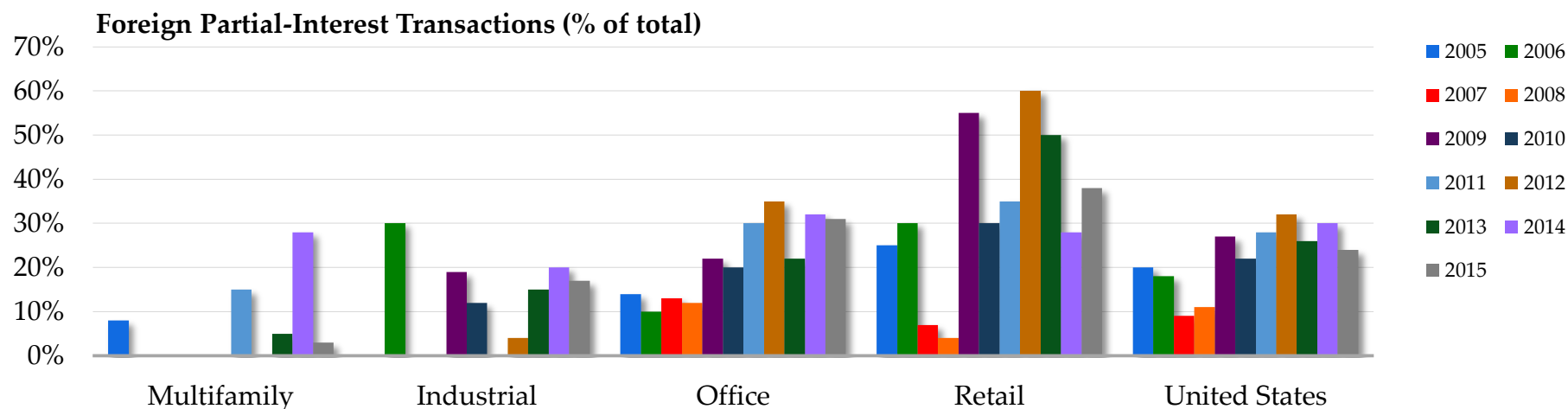
Increased REIT ownership limit to 10% from 5%

Foreign Pension Funds exempted from FIRPTA

RICs granted permanent status as Qualified Investment Company

- Recent reforms to the Foreign Investment in Real Property Tax Act (FIRPTA) will impact demand for minority, partial-interest transactions from qualified investors.
- New regulations exempts foreign pension funds from FIRPTA and expands permissible ownership stakes in publicly traded REITs up to 10% from the previous cap of 5%
 - Pensions accounted for approximately 17% of Asian investment activity in U.S. CRE between 2011 and 2015
 - Japanese pensions are facing low domestic yields and have approximately \$3 trillion in AuM, potentially spurring demand for U.S. CRE

Foreign Partial-Interest Prevalence is Rising and Currently Averages 27.4%



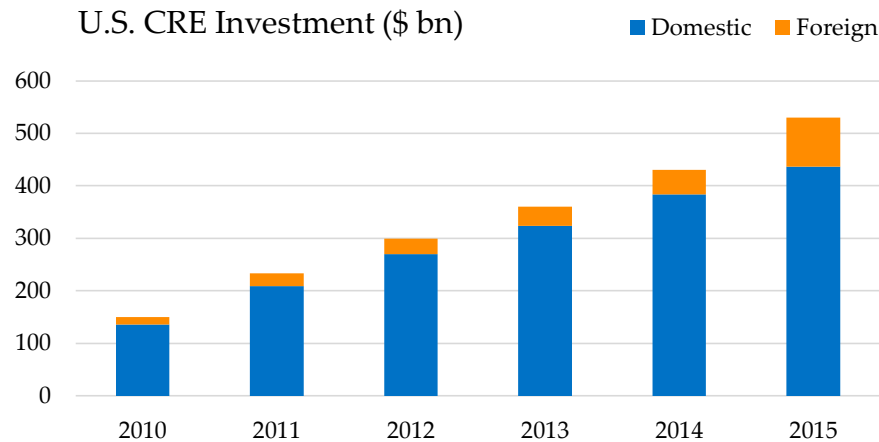
Source: JLL Research, Real Capital Analytics (Transactions large than \$5.0m)

EB-5 Key Trends

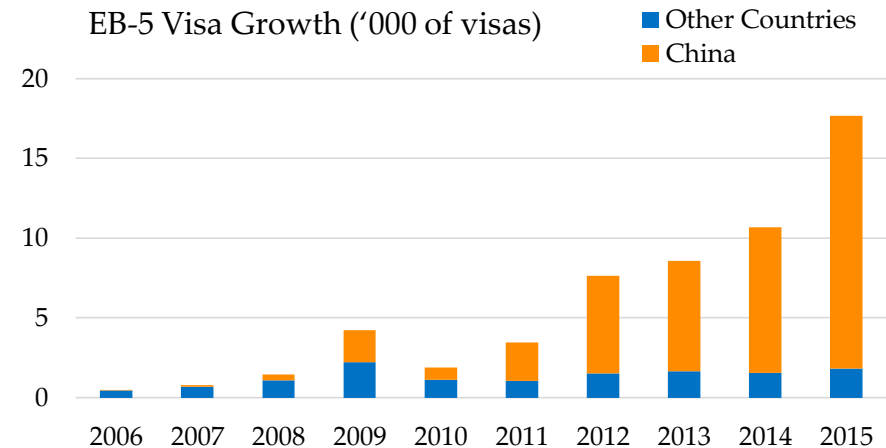


EB-5 investment activity has increased dramatically amid strong demand for U.S. real estate from foreign investors and increased ease of access offered by the regional center and loan funding model

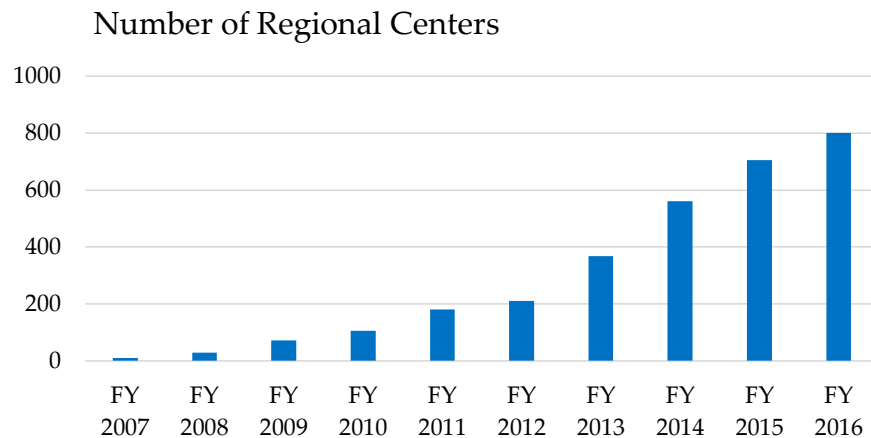
Strong Foreign Demand for U.S. Real Estate



Continued Demand for Chinese Investors



Regional Centers are the Preferred Vehicle



Loan vs. Equity

Indicative EB-5 Project Capitalization	Amount (%)
Senior Loan	60
EB-5 Mezzanine Loan	30
Developer Equity	10
Project Total	100

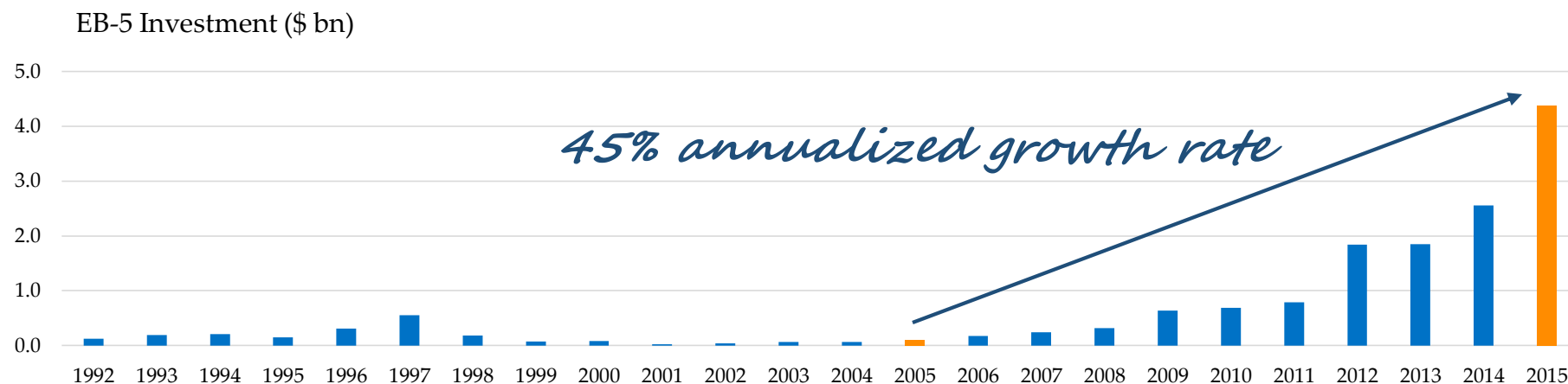
Source: IIUSA, Morgan Stanley, RCA, USCIS

EB-5 Challenges



Visa quotas and increased regulatory oversight have created challenges for EB-5 fund raising

EB-5 Investment Activity has Increased Significantly



Key Challenges Facing the EB-5 Financing Market

Challenges	Additional Considerations
Increased Competition for EB-5 Capital	<ul style="list-style-type: none"> Developers are facing increasing competition for EB-5 capital. Importantly, completion is often not based on economic returns. Instead, job creation certainty and return of principal are the primary considerations Largest developers with the highest profile projects in gateway cities may be at an advantage
Retrogression	<ul style="list-style-type: none"> Significant delays and increased uncertainty could diminish the appeal of EB-5 investments Timing considerations around release of funds (escrow bridge vs. guarantee) and return of capital
Regulatory Oversight	<ul style="list-style-type: none"> The SEC and other regulators have become increased their scrutiny of EB-5 capital fund raisers

Source: IIUSA

A Closer Look at EB-5 Retrogression

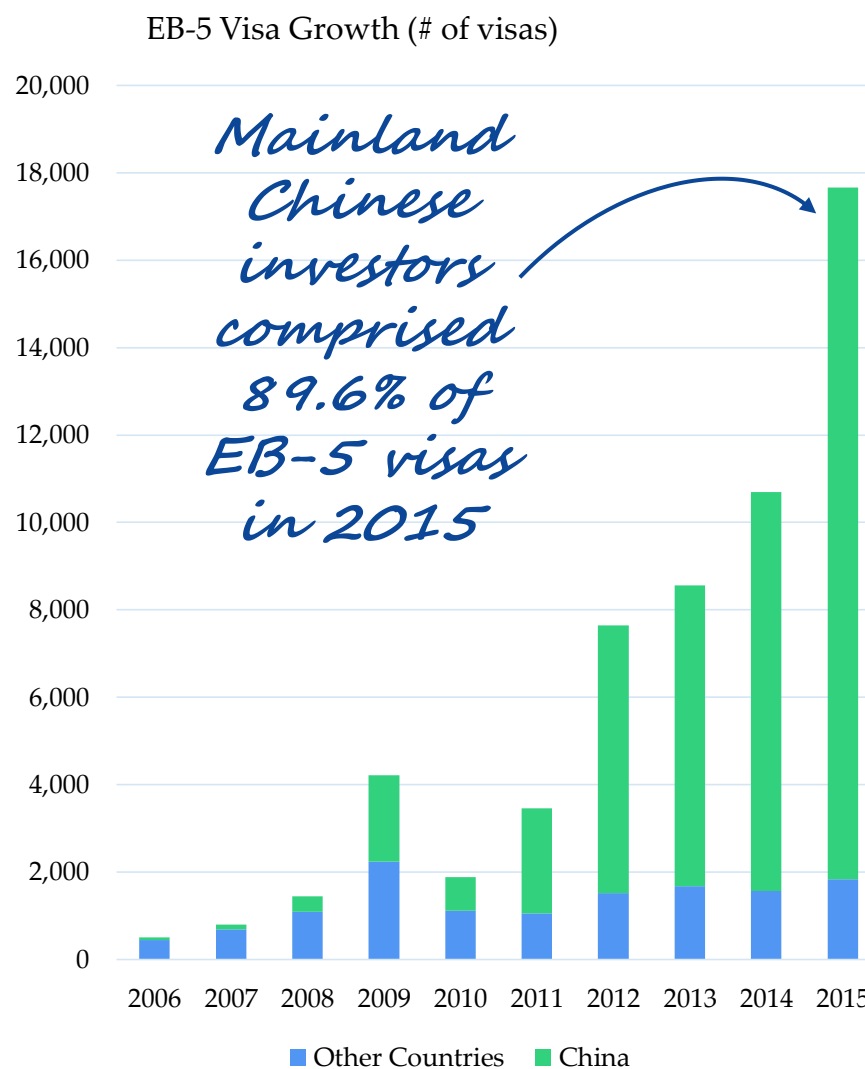


Chinese investors currently face retrogression delays of approximately 2 years. Retrogression has the potential to lengthen EB-5 investment time frames and complicate the process for investors, regional centers and developers

Retrogression Summary

- The Department of State first announced retrogression for Mainland Chinese investors in August 2014
 - However, the development had only minimal impact since it occurred near the end of the U.S. government's fiscal year
- The May 2015 Visa Bulletin confirmed retrogression for Mainland Chinese investors, setting a cut-off date of May 2015
 - The retrogression was widely expected and had been previously announced by the Department of State's Chief of Visa Control and Reporting, Charles Oppenheim, during an April conference
 - Oppenheim had been warning industry participants of a likely retrogression since October 2014
- The current November Visa Bulletin continues to show a 2 year delay with a cut-off date of November 2013
- Additionally, the retrogression backlog is expected to grow
 - Chinese investors may rush to get in line
 - **Industry participants only expect 6-8 months of applications to get processed each year, resulting in the backlog extending by 3-6 months each year**
- However, future legislative changes could reduce or eliminate the backlog pressures by removing individual country caps

- EB-5 Program Continues to Grow in Popularity



Source: Bloomberg, IIUSA, USCIS

Potential Impacts of Retrogression



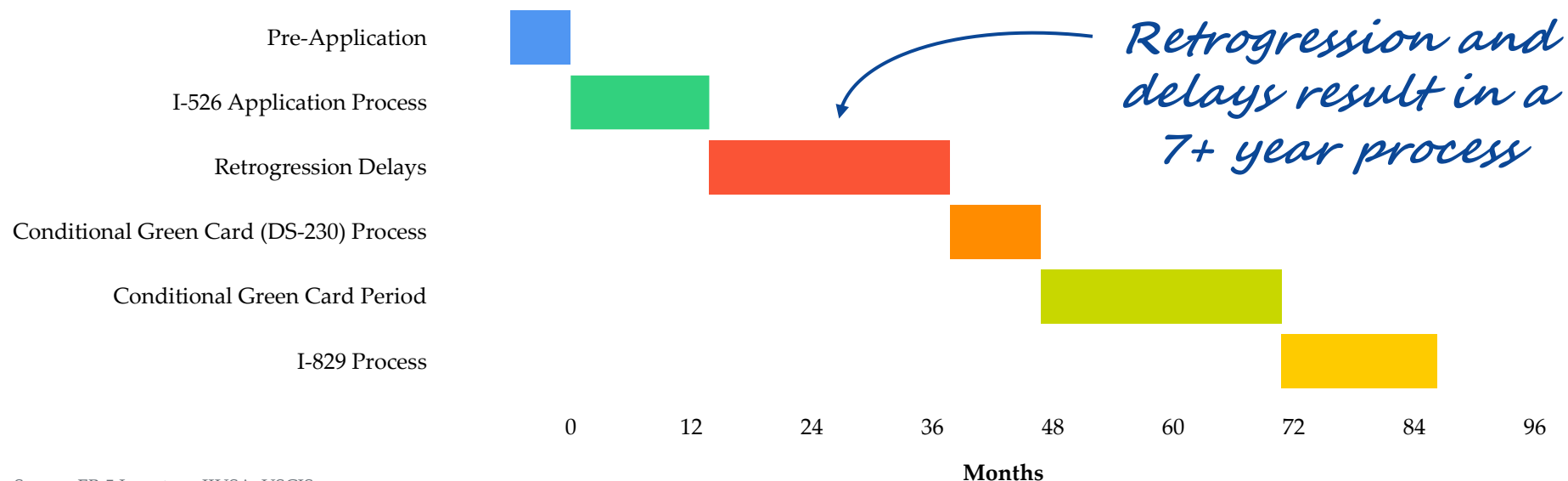
Chinese applicants seeking to invest regional centers are more likely to face USCIS processing delays. When combined with retrogression, the EB-5 process can easily extend to 7+ years

Source: IISUA, Klasko, USCIS

Retrogression and USCIS processing delays result in a significantly longer process



Impact of Retrogression and Processing Delays



Source: EB-5 Investors, IISUA, USCIS

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