China's Anbang Insurance Group Co will acquire The Blackstone Group's Strategic Hotels & Resorts portfolio of 16 luxury assets for about US$6.5 million. The portfolio includes three US properties:

Loving leisure

Chinese investors seek out hotel assets in Asia and abroad

by Alex Frew McMillan

When we think of going on holiday, we think of the adventure of travel. The allure of seeing new sights and experiencing new cultures in exotic and far-off locations is compelling for many. And as the middle class grows in Asia — particularly in China — tourism has increased. More than 133 million Chinese individuals travelled overseas in 2015, up from 116 million in 2014, according to the China Outbound Tourism Research Institute.

The number is only likely to increase. "Amazingly, this would seem to be only the start, as only a small proportion of China and the wider Asian population currently is travelling overseas," observes Marc Socker, managing director of the hotel fund management team at Invesco Real Estate in Europe.

The countries with easier visa systems for Asian travellers will benefit the most in terms of tourism, of course. But while Asian overseas tourism is still relatively low, Chinese investors in particular have been acquiring existing, strong hotel brands across the global to diversify their portfolios. In Europe and Asia, Jin Jiang International Holdings Co has acquired Louvre Hotels Group, Fosun is acquiring Club Méditerranée, and HK CTS Metropark Hotels Co has bought Kew Green Hotels. After all, tourism and hotel stays often go hand-in-hand, with the tourism and hospitality industry representing a top five GDP driver in most Asian economies. And the category is expected to grow. Hotel transaction volume within Asia in 2015 was about US$10 billion, according to JLL. And research from CBRE

the JW Marriott Essex House in New York City (left), the Fairmont Scottsdale Princess in Arizona (centre) and the Hotel del Coronado near San Diego (right).

indicates Asian capital into European hotels has increased 393 percent since 2007.

"Chinese investors know better than anyone else about Chinese travellers, going forward," says Vincent Felteau, portfolio manager at Presima. "They probably know outbound travel by mainland Chinese should increase exponentially in the future. They also know better than everyone else how Chinese people like to travel."

Not to miss out, firms such as Fairmont Raffles Hotels International, Mandarin Oriental International and Shangri-La Hotels and Resorts also are keen on entering the European market. Whether budget or luxury, European hotels are attracting interest from Asian buyers.

"They see more upside potential due to the weak euro and stabilising economies, and the fact that the US economy may be topping out," explains Tony Ryan, managing director for global mergers and acquisitions with JLL's hotels and hospitality group.

Chinese insurance companies only recently have been allowed to invest in real estate and to invest abroad. The long-term nature of such investment meshes very well with their obligations in terms of insurance payouts.

Anbang grabs headlines

Beijing-based Anbang Insurance Group Co may be the most headline-grabbing investor of them all, having walked away from its US$14 billion bid for Starwood Hotels & Resorts Worldwide, following a heated bidding war with Marriott International.

"Buying assets is one thing; acquiring a significant, global operating business such as Starwood is something very different," says Sonny Kalsi, co-founder and managing partner of GreenOak Real Estate. One of the lures of a global business acquisition, he notes, is "the opportunity to grow around the world and not just in any one market."

While Anbang withdrew from the Starwood deal, the insurance company is due to complete its purchase of Strategic Hotels & Resorts from The Blackstone Group for approximately US$6.5 billion.

It is a handy bit of business for Blackstone, which bought Strategic Hotels & Resorts only last year for US$6 billion. Aside from transaction fees, Blackstone made a healthy profit in four months. But at the same time, Anbang has bought an entire hotel portfolio — 16 luxury properties with 7,532 rooms — in one go. The portfolio of US assets includes brands such as Four Seasons and Ritz-Carlton, and properties such as JW Marriott Essex House in New York City, the Fairmont Scottsdale Princess in Arizona and the Hotel del Coronado near San Diego. Anbang could have pieced together various hotel deals to achieve a similar portfolio, but the insurer accomplishes this with one trade.

In 2015, Anbang made headlines when it acquired New York City's landmark Waldorf Astoria Hotel for US$1.95 billion. The deal was the largest single-asset US hotel transaction of the year, according to Real Capital Analytics. In 2015, single-asset hotel transactions totalled US$29 billion, a record level.

"Chinese institutional investors and conglomerates are pursuing a sophisticated, long-term strategy to tap into a key global economic driver," notes JLL's Ryan.

Another case in point: In early May, Cindat Capital Management — backed by investors including China Cinda Asset Management Co and Taikang Life Insurance Co and its affiliate — closed on its 70 percent joint-venture acquisition of seven premium limited-service hotels in Manhattan for US$571.4 million from Hersha Hospitality Trust, which retains the remaining 30 percent interest.

Investment decision drivers

Because such a low percentage of their investable assets are in property holdings, Chinese investors may hesitate to deploy much more capital within China's borders but would find the developed markets of Western Europe and the United States attractive. Given their own experience in their home market, they may even be open to investment in developing regions, such as South America, Eastern Europe and Africa.

Institutional investors are fully aware China is undergoing significant changes, including transitioning its economy from a manufacturing one toward a more consumption- and service-oriented one, but it is clear this transition is not a smooth one.

It includes a lot of risks, such as even-slower economic growth, and the significant exodus of capital outside the country. It also relies on the government to get this process right. For these reasons, it makes sense for insurance companies in China to look for diversification elsewhere around the globe, in countries that probably are considered much safer in the current volatile environment.

One transitional factor to consider is the yuan. The outlook is increasingly negative, believes Presima's Felteau.

Chinese investors face an increasingly challenging transition in terms of the Chinese economy. The People's Bank of China has aggressively lowered its benchmark interest rate, which, in turn, puts tremendous pressure on the yuan.

Based on this trend, many investors in China believe there is a downside of 10 percent to 15 percent on the yuan from current levels, notes Felteau. Given that currency risk, "many Chinese institutional investors are looking to transfer some of their locally-denominated currency exposure to foreign markets to protect the value of their assets, in relative terms," adds Felteau. "Selling local real estate assets and buying foreign real estate assets" helps accomplish this feat from a currency-exposure perspective.

Chinese insurers, facing an ageing population, increasing liabilities in their home market, and lower investment returns from domestic assets, are on the hunt for stable investments overseas that will produce regular, predictable income. Real estate delivers both big-ticket assets and dependable returns.

Assets in countries such as the United States are much more dependable in terms of tenant mix than China and, therefore, more attractive to institutional investors. Even though we hear about residential markets in Shanghai and Beijing going through the roof, office real estate is not always the easiest to sell or rent.

"Real estate assets in developed markets such as the United States are generally perceived to offer more stable yields because they are more mature in most cases, therefore considered stabilised from an occupancy standpoint, versus real estate assets in developing markets, which are often in leasing-up stages," explains Felteau. "From a risk perspective, real estate assets in developed markets are also generally leased to high-quality tenants having a good credit profile, therefore providing more sustainability of their cashflow streams."

And given the sheer amount of capital Chinese institutional investors have available to deploy, in general real estate investment opportunities in China — with the consistent risk-adjusted returns being sought — may not be as readily available, according to Marc-André Flageole, a portfolio manager with Presima. "With large sums of money to deploy, it appears rational to seek exposure to different economic growth potential, and perhaps also to a larger basket of currencies," adds Flageole.

Core assets in prime global locations, of course, are always a draw for institutional investors, and activity in the Asia Pacific region is no exception.

Asia Pacific competition

To some extent, explains Ryan, real estate investment in the hospitality industry will follow the tourism money. Chinese tourists currently are targeting Japan and Australia as their favourite destinations, and both nations have weak currencies. The situation should change, but it is likely Chinese investors will ride even the worst of any currency fluctuations.

In Asia Pacific, M&G Real Estate is focusing on Japanese and Australian hotels. The economies seem the strongest, and the currencies are also at a relatively-low point, given a good entry point.

"A weak currency is a win-win situation for tourism sectors," says Dr Cuong Nguyen, head of research with M&G Real Estate Asia. "Countries become more appealing to foreign visitors, and also get more domestic travellers, as making overseas trips becomes more expensive." Both Japan and Australia offer wide ranges of tourist attractions.

M&G Real Estate bought The Olsen and The Cullen hotels in Melbourne for a total of A$146 million (US$111 million). The Deague family, which owned both, came out in the press to say it was not selling the entire "Art Series" of hotels, of which both were a part.

"The sale comes at an opportune time in the Australian hotel market with record-low yields," William Deague, CEO of the family's investment firm, Asian Pacific Group, told *The Australian*. "We have committed to a very long lease back on all

properties, which we will continue to develop and operate as normal."

Deague also notes the company is committed to the brand and currently is in talks for sites in the United Kingdom and Los Angeles. The deal was something of a coup for M&G Real Estate because Chinese investors also were interested. It is difficult to compete against such institutional investors because they have so much capital and are willing to deploy it rapidly to scoop up hotel portfolios.

Nguyen says Chinese investors have injected a lot of bullish sentiment into the hospitality sector — hospitality was always a niche sector, but it has been getting a lot more attention lately. In terms of transactions, "it's very clear the volume is rising year-on-year," notes Nguyen. "We are positive on the sector."

Capital deployment challenges

It is more difficult, however, for investors to deploy capital in the hospitality sector. Owners rely on the hotel operator for information on occupancy and average room rates, where similar statistics for an office property would be readily apparent.

Asia Pacific international visitor arrivals

Location	International visitor arrivals, 2015 (m)	Year-over-year change
Bali, Indonesia	4.0	6.2%
Bangkok	19.3	24.8%
Beijing	4.2	–1.8%
Brisbane, Australia*	0.6	n/a
New Delhi**	13.9	3.9%
Hanoi	3.3	10.0%
Ho Chi Minh City	4.7	6.8%
Hong Kong	59.3	n/a
Jakarta	2.3	2.6%
Macau	30.7	–2.6%
Malaysia^	23.1	–15.7%
Maldives	1.2	2.4%
Melbourne^^	1.1	n/a
Mumbai	11.6	4.6%
New Zealand	3.2	10.7%
Osaka, Japan	4.2	77.0%
Philippines	5.4	10.9%
Phuket, Thailand	3.5	8.7%
Seychelles	0.3	18.7%
Shanghai^	8.0	1.1%
Singapore	15.2	0.9%
South Korea	13.2	–6.8%
Sri Lanka	1.8	17.8%
Sydney^^	1.6	n/a
Taipei	10.4	5.3%
Tokyo	16.4	n/a
Yangon, Myanmar	1.3	15.0%

** International passenger traffic, YTD September 2015*
*** International passenger traffic*
^ YTD November 2015
^^ YTD September 2015
Source: JLL's Hotel Destinations Asia Pacific, *March 2016*

At JLL, Ryan says Chinese investors are targeting major international destinations such as New York City, Los Angeles, San Francisco, London and Paris. In Asia Pacific, they are looking at Sydney, Tokyo, and Japanese tourist spots such as Hokkaido. But Vietnam and even the Maldives are worth watching, notes Ryan.

Within China, however, is a glut of five-star hotels. Even small cities, it seems, have a gleaming new Ritz-Carlton. The sweet spot, according to Nguyen, is four-star hotels that gather trade from business travellers and also appeal to tourists. At the low end of the market, customers may shift to short-term rental options such as Airbnb. But further up the scale, you can acquire corporate accounts that equate to regular business.

In Asia, Nguyen is focusing his attention not only on the destinations of Chinese travellers, but also where the rising middle class from Southeast Asia is visiting. The booming populations of nations such as the Philippines, Indonesia and Vietnam are yielding relatively-wealthy citizens who are, for the first time, considering venturing abroad.

The issue, for Nguyen and M&G Real Estate, is that it may be easy to buy a hotel in a Southeast Asian market but hard to sell it later. The illiquidity of the market stymies many a deal and causes most of those nations to be an "insider's game".

"Running a hotel relies a lot on the operator, and it will be very asset-specific," says Nguyen.

Nevertheless, hotels have outperformed many other sectors in recent years and benefit immediately when the number of travellers increases. In contrast, other property sectors, such as office, must wait a lot longer from a pickup in sentiment, relying on rent renewals to improve returns.

The bottom line

Much as a greater number of Chinese tourists are expected to travel to popular destinations, the rapid rise of (1) some Asian populations, (2) the middle class, and (3) tourism to and from many Asia Pacific nations is something for investors to watch.

"In general, hotels offer investors a return profile with short-term leases, which are typically more levered to growth in the economy than other more stable real estate sectors," says Presima's Flageole. Given this, hotel investments could be a good fit for Asian investors targeting growth, rather than the higher visibility and stability of cashflows typically offered by other real estate asset classes, adds Flageole.

But with all the positives going for the hotel sector, GreenOak's Kalsi cautions it is more volatile — and more cyclical — than just about any other asset class, noting it is "a great sector to play early in an economic recovery, but the first sector to correct — and quickly — in an overall economic downturn."

With that caution duly noted, relax and enjoy your stay. ❖

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