Control Risks

HIDDEN RISKS IN NORTH AMERICAN FOREIGN DIRECT INVESTMENT

2015

Managing Risk | Maximising Opportunity

Report compiled by Control Risks experts worldwide.
By Michael Moran

Published by Control Risks, Cottons Centre, Cottons Lane, London SE 1 2QG. Control Risks Group Limited ('the Company') endeavours to ensure the accuracy of all information supplied. Advice and opinions given represent the best judgement of the Company, but subject to Section 2 (1) Unfair Contract Terms Act 1977, where applicable, the Company shall in no case be liable for any claims, or special, incidental or consequential damages, whether caused by the Company's negligence (or that of any member of its staff) or in any other way.

Copyright: Control Risks Group Limited 2015. All rights reserved. Reproduction in whole or in part prohibited without the prior consent of the Company.

TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION 3

OPPORTUNITY LOVES COMPANY 4

Japan’s acquisitive 80s: A case study 5

WHERE GOOD DEALS GO WRONG 6

WHEN POLITICS DRIVES REGULATION 8

POLITICAL RISK: THE DANGER OF SETTING LINGERING PRECEDENTS 11

The influence of interest groups and business rivals 11

The dynamic potential for public activism in North America 11

Sensitivities surrounding iconic or sensitive brands or industries 12

CONCLUSION 14

EXECUTIVE SUMMARY

With the US and Canadian economies growing briskly at a time when growth in emerging markets (EM) and the European Union (EU) has slowed significantly, North America has made a comeback as a destination for foreign direct investment (FDI). Citing North America's relative stability and transparent regulatory regimes, many potential investors discount the notion of political risk while staking their claim to the region's growth story. They do so at their peril. The security, corruption and acute political risks associated with the rush into emerging and frontier markets over the past decade indeed may not be present. Still, Control Risks' assessment of the business and political risk environment suggests a sloppy approach to market entry, due diligence and political assessments can be every bit as fatal to FDI in North America as in the most opaque developing land.

0.1750
0.1500
29May
6
13
Jun
10
17
24
21
27
Jul

But there is no political risk in the United States. It's just regulatory risk, and for that we pay American law firms.

Large Asian sovereign wealth fund

INTRODUCTION

Viewed from the vantage point of global investors in a moment of economic volatility, the economies of North America appear calm and tempting. With few barriers to entry, at least on the surface, global investors have pushed FDI in both Canada and the United States to new heights. But don't let outward appearances – or the words of a large Asian sovereign wealth fund quoted above – fool you. The US and Canada may not pose the acute security and corruption risks associated with frontier markets such as sub-Saharan Africa, but the complex cultural, institutional, legal – and in the US, particularly, political – sensitivities can pose existential threats to any endeavor. Entry into the North American market requires careful preparation.

In both Canada and the United States, political risks loom. Whether the prospective investor is a Middle Eastern sovereign wealth fund (SWF), a privately-held Chinese real estate private equity fund or an EU-based multinational, questions about motives, sources of capital, anti-trust, transparency and even national security will apply. At times, seemingly obscure or random dynamics have scotched major investment opportunities as national or regional champions, industry or politically motivated lobbying groups and even wealthy individuals emerge as sudden and highly effective obstacles. This is an expensive lesson to learn: for China-based firms alone, many of the investment and acquisition bids launched between 2005 and 2014 failed, often due to insufficient understanding of the political and economic context of the deals.[1] Concerns about political backlash caused investors from the Gulf to revise their approach to US investments, which now favor real estate and equity deals over outright acquisitions.

Canada and the US as societies emphasize public openness and market competition and foster an aggressive regulatory and media environment. This makes public opinion a major factor, particularly for deals involving large labor pools, well-established brands or symbols of national wealth or progress. "With political stability and a sound legal system, the US generally does not face typical political risks of regime change, coup d'etat and social disturbance," notes a 2013 report from the Brookings Institution, a Washington-based think tank. "But the dynamic political environment on which US public governance is based tends to make Chinese investors unfamiliar with such an external environment vulnerable to active risks."[2]

To some extent, the learning never stops. In the EM context, many western multinationals have come to grief assuming they had the risk appetite and internal capacity – or perhaps just the cash – to see through investments in politically fraught environments without extensive pre-entry analysis or other due diligence. This, in Control Risks' experience, has proven a prescription for trouble. Similarly, the central banks of the Group of Seven (G-7) nations have come around to the once quaint notion that balance sheet economics – a clear-minded assessment of national debt and repayment risk – is every bit as relevant to an Organization of Economic Cooperation and Development (OECD) country as to, say, Zambia. In the post-Lehman Brothers world, no country can be assumed to be risk free. That investments are presumed safe by everyone at corporate headquarters will be of little solace when due diligence failings, a lack of contextual knowledge or execution errors sink the deal.

The dynamic political environment on which US public governance is based tends to make Chinese investors … vulnerable to active risks.

Brookings Institute

[1] The China Global Investment Tracker, joint project of the Heritage Foundation and American Enterprise Institute. Accessed 1/28/2015. http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map

[2] Qiao Yu and Shuqing Zhang, "A Study on the Exertnal Environment for the Investment of Chinese Enterprises in the United States," Brookings-Tsinghua Center for Public Policy, August 2013

OPPORTUNITY LOVES COMPANY

The good news in North America is that many of the most acute risks are exceptionally rare. For example, when DP World (then Dubai Ports) bid to run some of the busiest shipping terminals in the United States in 2006, a political uproar that killed the deal was probably predictable. But current risks may not be so obvious, nor confined to the federal level of the US or Canadian governments.

That said, the region abounds with opportunity. Current global GDP growth trends, the ending of the US Federal Reserve Bank's quantitative easing (QE), and the strengthening dollar all point to a continued growth of FDI in the US and Canada. Inbound FDI to the US reached a record $236bn in 2014. EU nations and Japan have dominated those statistics historically, but trends suggest that Brazil, China, Colombia, India, Indonesia, Malaysia, and South Korea as well as other EM countries are moving up the rankings.

While the rebalancing of North American inbound FDI from Europe to the EM world is general, unsurprisingly it is Chinese money – 70% of it from Chinese firms in private hands – which has grown most quickly over the past decade. For example, from 2008 to 2014, US Commerce Department figures show that China's US bound FDI grew at an annual rate of above 60%. The pattern is the same in Canada: EU and US investment predominates and yearly variations skew growth figures, but the trend growth in inbound FDI is almost entirely from the EM world.

While the relative stability of the business environment will be a tonic to those accustomed to the sometimes lethal problems of the EM, there is a real threat in overlooking potential trouble in less tumultuous environments. Risk rarely hits one in the face in North America; rather, it hovers subtly around the business landscape, and can gestate rapidly and lead to reputational, political and regulatory problems, whose cost in dollars and lost return on investment (ROI) can threaten the entire enterprise. Some of this is regulatory in nature, and

Inward investment from leading countries 2012-13 (in millions of dollars)

Country	2012	2013	Percent Change
Japan	$24,830	$44,861	81%
United Kingdom	$25,250	$41,909	66%
Luxembourg	$8,673	$26,101	201%
Canada	$15,339	$23,336	52%
Switzerland	($2,439)	$16,994	n/a
Ireland	($1,027)	$15,351	n/a
Netherlands	$36,009	$12,821	-64%
Germany	$7,337	$11,859	62%
Norway	$2,787	$9,256	232%
U.K Islands, Caribbean	$5,942	$8,801	48%
South Korea	$5,616	$6,632	18%
France	$22,882	$3,326	-85%
Mexico	$2,035	$3,130	54%
China	$3,491	$2,419	-31%
Denmark	$119	$2,374	1895%
Bermuda	($3,101)	$2,310	n/a
Italy	$2,226	$2,138	-4%
Sweden	$2,066	$2,087	1%
Sweden	$1,654	$1,686	2%
Hong kong	$1,334	$1,390	4%

Source: Bureau of Economics Analysis

sound legal and tax advice can mitigate much of the risk. However, in the background of many deals lay dormant political and cultural sensitivities which, if awakened, can entangle a bidder or suitor in complex, expensive delays and enforcement action that can last for years.

Middle East and North Africa (MENA) investors learned in 2006 that viewing such deals primarily from the balance sheet can be a costly error. Dubai-based DP World's decision to acquire operational control of some of the largest container ports in the United States made enormous financial and technical sense. There was no question the company could handle the job, nor any doubt about funding. But the fact that a sovereign – in this case, the Gulf emirate of Dubai – was behind the potential suitor charged the political atmosphere in the US.

"The issue of sovereign wealth funds has widened beyond investment-related or purely economic considerations," writes Jassim al Mannaie, Director-General and Chairman of the Board of the Arab Monetary Fund, an Abu Dhabi-based financial arm of the Arab League. "It has been politicized and become a phenomenon of international concern. Dealing with the issue, therefore, should not be limited to investment professionals, but include the best expertise available in the areas of international political and economic relations as well."

Derek Scissors, a resident scholar at the American Enterprise Institute (AEI), estimates that many deals go awry because foreign investors underestimate the abstract cultural and political challenges involved. "There are a lot more of these deals that might have gone through but for a mishandling or misjudgment of political risk," says Scissors, who compiles the China Global Investment Tracker for the AEI. "But there is also execution risk."[3]

JAPAN'S ACQUISITIVE 80S: A CASE STUDY

There is historical precedent to China's situation, but also reason to believe that careful study of market conditions, as well as of cultural and political factors can ultimately mitigate these problems out of existence. In the 1970s and 1980s, the industrial base of the United States – undamaged by the ravages of World War II and thus far more likely than its global competitors to be approaching obsolescence – suddenly met its competitive match, primarily from newer, more efficient Japanese and German plants. The US balance of trade, starting from a near balance in 1970, opened up quickly in the years that followed, with Japan's surplus growing particularly fast. This energized a coalition of American regional and sectoral interest groups, from organized labor to Midwestern 'rust belt' constituencies to lobbyists representing the US auto, steel and other heavy manufacturing industries. Throughout this period, political pressure from Congress grew on successive US presidents to protect American industry from Japanese imports, a position anathema to the free trade presidents of the day. For the most part, while the anti-Japan sentiment spawned some bad jokes and a few mediocre films (Gung Ho, Rising Sun, Black Rain), outright protectionism was avoided. However, as Japan's spending spree reached a climax in the mid-1980s, public pressure to act became acute, leading to concrete changes to the terms of trade: import surcharges, antidumping sanctions, and voluntary export restraints. Only in the mid-1990s did Japan take steps to defuse these problems, in part as a reaction to the North American Free Trade Agreement (NAFTA) establishing major automobile and electronics manufacturing plants within the United States, Canada and Mexico that changed the regional perception of Japanese multinationals from predatory competitors to job creators. Today, Japan's annual FDI into the US regularly tops $40bn and is subject to intense courtship from US state and municipal governments.

[3] Interview with the author, Jan. 31, 2015.

WHERE GOOD DEALS GO WRONG

Even today, with a US administration actively pursuing FDI abroad, headlines like “The coming deluge: Should the US fear Chinese investment?” (Fortune, October 28, 2014) speak to this dissonance, harkening back to the heyday of 1980s ‘Japanophobia,’ when Japan’s wave of inbound US FDI set off a xenophobic policy backlash (see sidebar article above). While the conclusions of such articles may favor FDI, the decision to cast these analyses in threatening terms is an acknowledgement of the broader public psychology.

“The assumption that regulatory and tax hurdles are the main challenge to investing in developed markets is a major reason for deal failures,” says Scissors, whose database has tracked Chinese global investments and acquisitions since 2006. For Chinese firms alone, this assumption led to hundreds of millions of dollars in legal costs, breakup fees and even penalties when deals went wrong. In some of the highest profile cases, their failure led to geopolitical fallout and damage to bilateral relations. In some cases, particularly in the US, such deals fall afoul of the chief US regulator of FDI, the US Treasury’s Committee on Foreign Investment in the United States (CFIUS). Particularly sensitive here is any deal that touches on weapons production, defense contracting or so-called ‘dual use’ technologies: that is, technology with civilian applications that could be turned to military purposes. According to its charter, CFIUS will weigh the wisdom of any sale or investment that might retard “the capability and capacity of domestic industries to meet national defense requirements, the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security, and the potential effects of the proposed or pending transaction on United States international technological leadership in areas affecting United States national security.”[4]

Indeed, the North American landscape is littered with drafts of expensively negotiated deals that never came to fruition. The best known of them all involved energy giant CNOOC, one of China’s state-owned enterprises (SOEs), which famously withdrew its bid for the US-based oil company Unocal in 2005 after a public outcry and threats of congressional scrutiny based on perceived national security issues. Unocal was ultimately sold to Chevron.

“CNOOC’s case could be fairly described as myopia,” Scissors says referring to the Unocal deal. “The assumption seemed to be that because they were the highest bidders, they would win the bidding. What they didn’t understand was the American political landscape and the incentives that exist for making political hay of these situations, nor did they get the concept of reciprocity. Could a US firm purchase outright a major Chinese energy company? The answer is no. That meant, really, this deal was doomed from the start.”

But CNOOC has also demonstrated that paying attention to the groundwork of market entry and due diligence can pay off. In 2012, having learned from its Unocal mistakes, CNOOC successfully acquired Nexen, a major Canadian oil sands operator, for $15.1bn. Another Asian SOE, Malaysia’s oil giant Petronas, purchased

[4] Foreign Investment in the United States: Major Federal Statutory Restrictions https://www.fas.org/sgp/crs/misc/RL33103.pdf

Progress Energy Resources Corp, another big Canadian energy player, that same year. Both have proven to be highly valuable assets. During CNOOC's acquisition of Nexen, the company set up a Toronto-listed subsidiary and pledged to make the city of Calgary (Alberta province) the hub of all its future North American operations. It also included a very high 'breakup fee' – some $145m – that would be owed to Nexen in case the deal failed due to execution errors on CNOOC's part. This can include anything from a failure to disclose issues that lead to regulatory rejection or a failure to arrange financing.

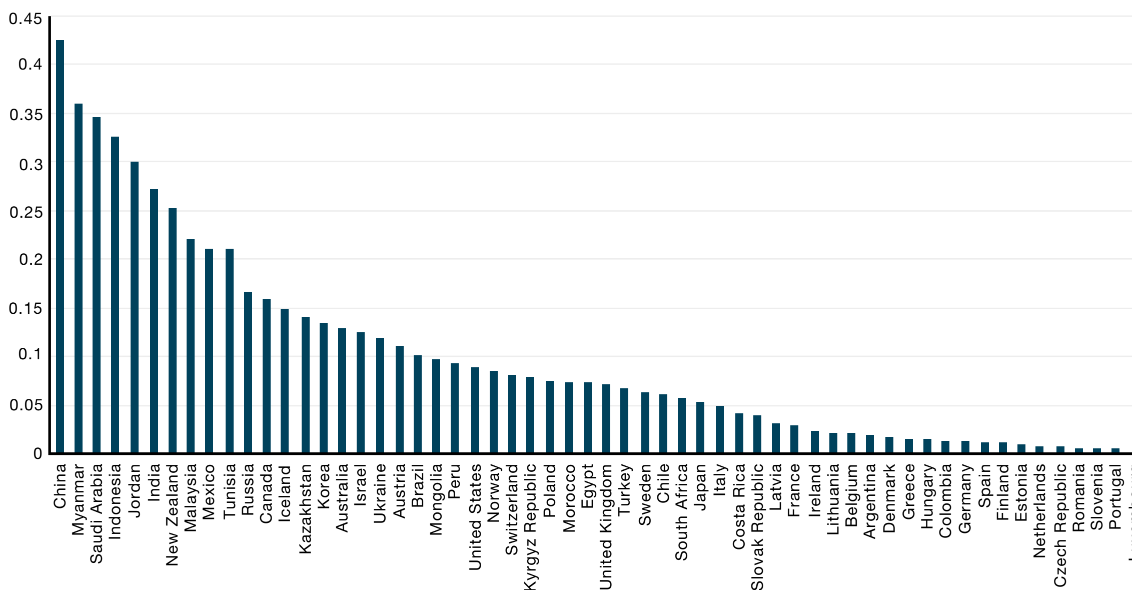
However, even in success, there are lessons in political risk. While the CNOOC and Petronas deals were approved, their status as state-owned entities drew criticism on competitive and other grounds in Canada and ultimately led to calls in parliament for a revision to the Investment Canada Act. The amendments raised the bar for the sale of 'strategic industry assets,' and singled-out SOEs for particular scrutiny, especially regarding ownership of oil sands. As Canada's Natural Resources Minister, Joe Oliver, said upon passage of the new legislation in late 2012, neither deal would have gained approval under the new standards.

WHEN POLITICS DRIVES REGULATION

These cultural and statutory hurdles, combined with restrictions based on national security concerns, rank Canada and the United States relatively poorly compared with their peer economies in the OECD. The OECD's FDI Restrictiveness Index is a measure of regulatory restrictions on FDI that focuses on equity restrictions, screening and approval requirements, restrictions on foreign key personnel, and other operational restrictions (such as limits on purchase of land or on repatriation of profits and capital).

While the US and Canada track fairly well when compared with EM countries, they are laggards among their OECD peers. In the OECD's 2013 index, Canada scored lower than all OECD members other than New Zealand and Mexico (the higher the index, the higher the restrictiveness to FDI). The US was eighth of the 34 nations making up the OECD's group of industrialized nations – just ahead of Mongolia and Peru. In the US, complex restrictions on the nature and percentage of foreign ownership exist across half a dozen sectors and subsectors. As chronicled recently by the Congressional Research Service (CRS), they include shipping, air transport, banking, mining and minerals, land ownership, energy, communications and government contracting.[5]

FDI regulatory restictiveness index, 2013



Source: OECD

[5] Ibid iv (Foreign Investment in the United States: Major Federal Statutory Restrictions https://www.fas.org/sgp/crs/misc/RL33103.pdf)

Some of these sectoral restrictions can be mitigated by ownership structures that establish legal entities in the United States. Others can take advantage of US EB-5 ‘investor’ visas, whereby wealthy potential immigrants to the US can qualify for citizenship if they establish a commercial enterprise that sustains ten full-time employees for at least two years. The program has been so popular with Asian investors that the US ran through its quota by August last year.

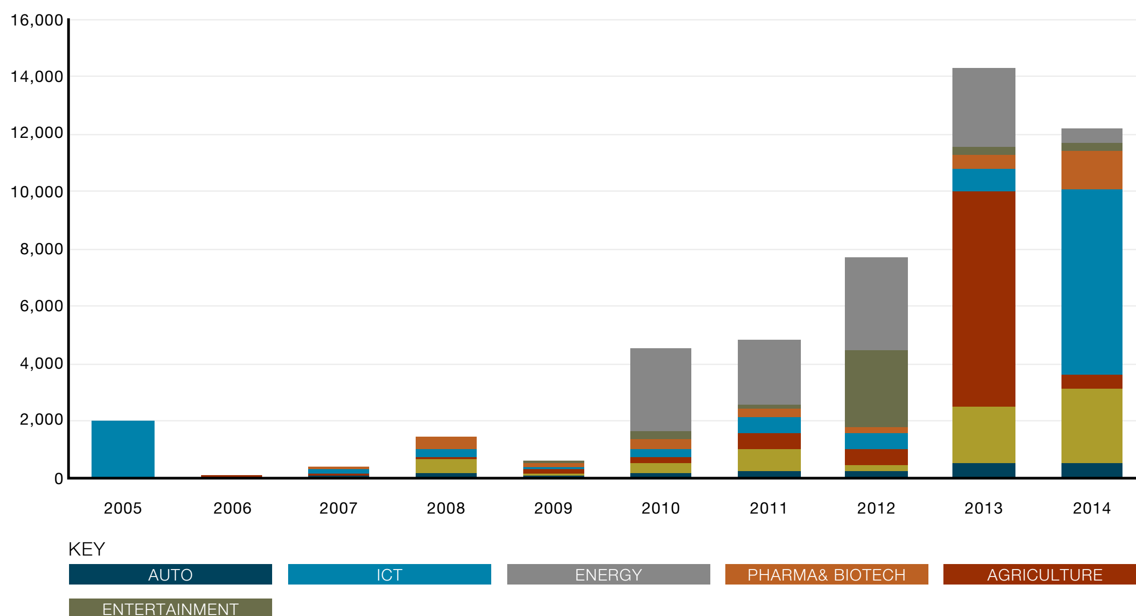
Added to this, depending on the scale of the investment in question, is scrutiny from the US Justice Department’s Anti-Trust Division, whose writ is broad and can potentially encumber a deal for a number of years as well as lead to withering fines.

Canadian law is less restrictive, officially placing foreign ownership caps on telecom, broadcasting and financial services. But Canada’s FDI review bodies – the independent government body known as the Competition Bureau, and the Investment Review Division of Industry Canada – pursue separate lines of inquiry, requiring duplicative and often onerous filing.

“Political risk is absent from probably 90% of deals,” Scissors notes. “But the politics can seem totally random when viewed from the outside.”

This randomness can be costly – in both time and money. A $1bn investment by Chinese SOE Sinopec, in a state-of-the-art coal gasification plant known as the Texas Clean Petroleum Project, has raised no regulatory red flags (though it is subject to local environmental questions). Similarly, the 2008 acquisition of App Tech Labs, a Minnesota-based biopharmaceutical company, by Chinese pharma giant WuXi Pharma Tech, sailed through US regulatory scrutiny. CIC’s purchase of a 10% stake in the investment bank Morgan Stanley and 9% of private equity giant Blackrock during the global financial crisis faced virtually no resistance, nor were hackles raised when two large Gulf funds went bargain hunting. Mubadala Development Corp bought 7.5% of the huge private equity fund Carlyle Group for $1.35bn in 2009; The Abu Dhabi Investment Authority paid $7.5bn for 4.9% of Citigroup. Both have been plagued by commercial challenges, and a spate of op-eds wondered aloud at the firesale in American financial assets. But given the gloom that pervaded the US financial sector in the wake of Lehman Brothers’ collapse, politicians apparently lost their appetite to challenge the transactions.

Chinese FDI Transactions in the US by Industry, 2005-2014



Source: Rhodium Group

But bids outwardly less controversial still set off warning signals. The $1.7bn bid by Beijing Superior Aviation for Hawker-Beechcraft in 2012 fell afoul of CFIUS when regulators determined the proposal to disentangle Hawker-Beechcraft's civilian aircraft business from its avionics division – which counts the US Defense Department among its customers – to be impractical.

Similarly, an effort by Chinese electronics firm Huawei to purchase internet cable and networking company 3com, was spiked by CFIUS when the US military and Homeland Security Agency raised concerns about putting the trunk lines of vital communications into the hands of a company run by a former senior officer of China's People's Liberation Army. The failure of the $2.2bn deal ultimately led 3com to claim a $66m termination fee from the primary broker, private equity firm Bain Capital.

POLITICAL RISK: THE DANGER OF SETTING LINGERING PRECEDENTS

In both of these cases, as with the earlier DP World and Unocal deals, some basic pre-bidding business intelligence and political and social risk assessment could have led to different outcomes.

Of course, in any endeavor, someone has to take the first step. While neither DP World nor Unocal represented the very first instance of inbound FDI from the United Arab Emirates (UAE) or China respectively, they clearly would have set precedents both in terms of deal size and the sectors targeted. That said, FDI from potentially sensitive source regions, whether MENA or East Asia, has risen steadily since the Unocal deal put such risks on the radar in 2005.

As in any complex undertaking, precedent helps create the business environment of today. The earlier missteps taught important lessons, but the ground continues to shift. Beyond the clear challenges of investing in so-called 'strategic industries' – such as defense, aerospace, energy and high technology – there are more subtle gradations of risk that any prospective investor in North America today should understand.

THE INFLUENCE OF INTEREST GROUPS AND BUSINESS RIVALS

While all countries have influential factions or individuals with unique access to the policymaking community, the checks and balances typical of governments in North America do not extend to the public sphere. By and large, nothing prevents an industry rival or adversarial interest group from seeking to directly influence the government's assessment of a given deal. This is particularly true in the US, where government agencies at the federal and state level may be compelled (either by statute or political realities) to hold public hearings on major planned infrastructure projects. At both the state and federal level, legislators generally have the power to demand hearings – if not in Congress, then certainly in state legislatures or by arranging 'field hearings' near the site of an acquisition target. Behind all of this, of course, is the fluid exchange of campaign funding donations that both federal and state laws allow. Corporations, US interest groups or political action committees (PACs) can fund (or withhold funding) from legislators almost without restriction if they structure their entity properly. Adding to risk here is the fact that foreign donors are prohibited from funding US election campaigns.

Canada's campaign finance laws are publicly funded and based on a formula that rewards good performance in the last election. Lobbyists are required to register with the government and are generally highly regulated. However, as in the United States, prominent individuals with access to high levels of government can influence policy.

THE DYNAMIC POTENTIAL FOR PUBLIC ACTIVISM IN NORTH AMERICA

Both in Canada and the US, public activism holds major disruptive potential for any major transaction involving a foreign partner. Groups ranging from environmental activists, economic populists, so-called 'patriotic' nativists and others exist in both countries. Understanding how to handle (or indeed, avoid) these factions can make the difference between a success and a failure. Case in point: the 2013 acquisition by China's Shuanghui

International Holdings of Smithfield Foods, a Virginia-based pork producer, for $4.7bn – the largest acquisition in the US to date by a Chinese firm. The purchase received significant public attention, both from conservative Republican members of Congress from Virginia and from CFIUS. At House hearings, Smithfield's CEO was grilled on whether he realized he was a communist dupe. But the deal made enormous industrial sense and Smithfield shareholders profited mightily. To address safety concerns, Smithfield had to assure the US government that it would not import pork from China – where food safety standards are suspect – into the US market.

However, even in success, the Smithfield deal has raised regulatory concerns – an echo of the post-deal legal changes that occurred in Canada after CNOOC's Nexen acquisition. It emerged after the sale closed that Shuanghui, renamed as WH Group, obtained a $5bn loan for the deal in an astonishing 24 hour period, a fact that raised questions about the Chinese state's role in the purchase and potentially complaints from Smithfield's private sector competitors. While Shuanghui clearly was not a state-owned entity, such fine distinctions may receive more scrutiny in the wake of the Smithfield acquisition.

SENSITIVITIES SURROUNDING ICONIC OR SENSITIVE BRANDS OR INDUSTRIES

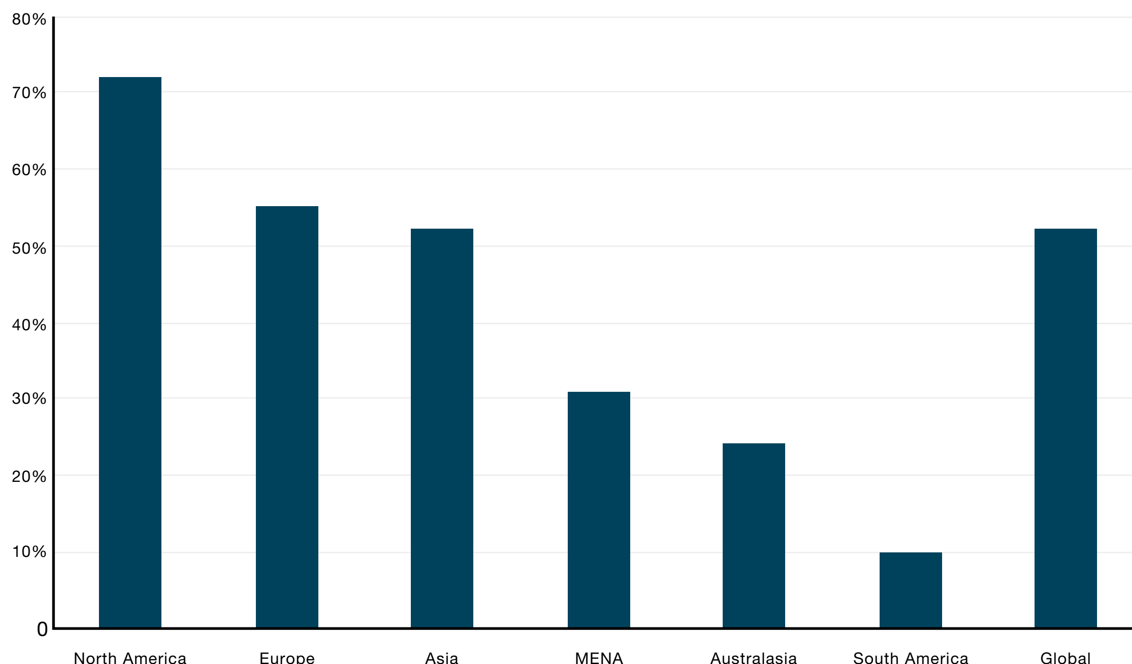
Japan's late 1980s acquisitions of some highly symbolic US assets highlighted the risks of misunderstanding cultural context. Mitsubishi's purchase of New York's Rockefeller Center, Bridgestone's absorption of Ohio's Firestone tires, even the purchase of an innovative Cray supercomputer by Japan's Ministry of Industry and Technology worried US regulators. More importantly, the trend led Congress to begin looking for ways to make it harder for the high-flying Japanese to shop for bargains in a US economy then in recession. By the late 1990s, US antidumping legislation and the popping of the so-called 'Japanese bubble economy' had led to a new approach: establishment of Japanese manufacturing plants in the US. After the 1996 NAFTA accord was struck, Canada and Mexico, too, saw Japanese firms establish major manufacturing concerns on their territory. For the most part, the job creation involved neutralized the antagonistic attitudes toward Japanese acquisitions, and Japanese FDI is widely sought after today. In recent years, cultural and political cross-currents in the US again have aligned in a way that makes this kind of risk a significant threat to certain purchases. In 2007, General Electric sold its GE Plastics division to the huge Saudi petrochemical combine SABIC, producing a flurry of objections but no regulatory obstacles. A year later, one of Abu Dhabi's SWFs bought the iconic Chrysler Building in New York, just one example of a torrent of real estate transactions that saw Gulf, European and Asian money vying for properties in major US markets.

This was the beginning of a very sharp increase in SWF activity in global real estate. Tata Industries, the Indian conglomerate, purchased the San Francisco-based Compton Hotel chain. DP World, far from shying away from the US market after the Dubai Ports debacle, instead shifted to real estate, acquiring 5.3% of MGM Resorts for $2.7bn just a year later. Other Gulf investors, too, remain highly active, including Aabar Investments PJS, which purchased 40% of electric-powered car maker Tesla in 2009, and a $20mn stake in private jet operator XOJET in order to establish a joint venture for corporate jet operation in the Gulf.

All have faced a smattering of hostile publicity, some generated by members of Congress. In August 2014, a $100 million deal by UAE-based Gulftainer to operate Florida's Port Canaveral container terminal won approval from CFIUS over the objections of several US congressmen. Rep. Duncan Hunter, a California Republican, denounced the approval and called on the Treasury Department to force CFIUS to reconsider. The administration has yet to state its position on Duncan's request.

In part because of such issues, investment groups, corporations and SWFs from around the world have shifted investment into US and Canadian real estate in recent years, a sector where investments usually proceed without rousing political opposition – at least at the national level. This has made North America by far the top destination for SWF real estate investments. Generally SWFs purchase 50% or less of these properties to avoid a longstanding US penalty tax upon the sale of the asset. But as Japan's experience in the 1980s shows, there may be a tipping point. Resentment that real estate prices are being driven up by foreign capital has been building in major US markets – and in Washington and Ottawa, too.

Regional Preferences of Sovereign Wealth Funds Investing in Real Estate



Source: 2014 Preqin Sovereign Wealth Fund Review

"In these kinds of transactions, there is no political sensitivity until there is," says Scissors of the AEI. "But once there is, once the tipping point of public perception is reached, it changes the game. It sets a precedent that investors ignore at their peril."

According to research from Dallas-based Invesco Real Estate, foreign investors account for about 20% to 30% of commercial real estate transactions in dollar terms in New York and Washington, and ten percent to 20% in areas including Los Angeles, San Francisco and Houston.

In late 2014, China's huge Anbang Insurance Group purchased the Waldorf-Astoria, arguably America's most famous hotel, for $1.95bn from Hilton. Was that a tipping point? Apparently not, because on 19 February, the fund made a second New York purchase – a midtown office building reportedly sold for over $400m. As the trend continues, however, local political reactions will need to be monitored lest they gestate into legislation or activism at the national level.

CONCLUSION

North America's economic health relative to the rest of the developed world has attracted foreign capital in record amounts – and not just to 'safe-haven' US Treasury bonds and blue chip equities. While Europe and Japan continue to make up the 'Top Ten' in terms of inbound FDI to the United States and Canada, China, the UAE, India, South Korea, Taiwan, Malaysia and other EM nations are moving up the league tables quickly and will likely displace some smaller European economies within the decade. Attitudes in the US and Canada are in flux with regard to this influx: for SOEs and SWFs, clearly, a higher bar exists for regulatory approval, and a much lower trip wire for public opposition looms, too. Private EM funds and corporates, too, face a changing landscape as each new major acquisition highlights the sometimes subtle, sometimes stark differences in the assumptions each counterparty brings to the deal making process. Executing a complex, multijurisdictional acquisition is difficult enough for two American companies in the current regulatory environment. The added layer of political and social and cultural risk involved cannot be ignored by foreign suitors if a deal is to survive the scrutiny of myriad interest groups, sectoral rivals or local activists who are simply averse to foreign ownership of any kind.

Control Risks' offices

abudhabi@controlrisks.com
alkhobar@controlrisks.com
amsterdam@controlrisks.com
baghdad@controlrisks.com
basra@controlrisks.com
beijing@controlrisks.com
berlin@controlrisks.com
bogota@controlrisks.com
chicago@controlrisks.com
copenhagen@controlrisks.com
delhi@controlrisks.com
dubai@controlrisks.com
erbil@controlrisks.com
hongkong@controlrisks.com
houston@controlrisks.com
islamabad@controlrisks.com
jakarta@controlrisks.com
johannesburg@controlrisks.com
lagos@controlrisks.com
london@controlrisks.com
losangeles@controlrisks.com
mexicocity@controlrisks.com
moscow@controlrisks.com
mumbai@controlrisks.com
nairobi@controlrisks.com
newyork@controlrisks.com
panamacity@controlrisks.com
paris@controlrisks.com
portharcourt@controlrisks.com
saopaulo@controlrisks.com
seoul@controlrisks.com
shanghai@controlrisks.com
singapore@controlrisks.com
sydney@controlrisks.com
tokyo@controlrisks.com
washington@controlrisks.com

www.controlrisks.com