

## **Bold US Investors Ignore Bubble Fears, Bet On Chinese RE**

by **Kaitlin Ugolik**

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Even as Chinese investors have poured funds into the strongest U.S. real estate markets in recent years, activity in the opposite direction has increased as bold U.S. investors look to capitalize on skyrocketing Chinese prices, despite worries about a bubble.

Chinese investment in the U.S. doubled last year, with the biggest gains coming in the food, energy and real estate sectors, according to data from research firm Rhodium Group. Chinese investors made 18 commercial real estate investments worth \$1.8 billion in 2013, including Zhang Xin's joint purchase of the GM Building in New York with Safra for \$1.4 billion in June.

Less attention has been paid to U.S. investment in China's real estate market, which is in what some analysts are calling the final days of a long trend of ever increasing prices. That hasn't stopped at least some wealthy U.S. investors and developers from taking a chance on China, trusting that if and when the bubble bursts, major cities like Beijing and Shanghai will be protected.

"China is a great real estate investment ... if you buy in the right place," Richard Lee of Salisian Lee LLP said in an email to Law360.

U.S.-based megadeveloper Silverstein Properties Inc. teamed up with a Chinese partner last month to buy land in a brand new, pilot economic zone in south China for 13.4 billion yuan (\$2.2 billion). The deal's price tag sets a record and makes Silverstein the first overseas developer to agree to take part in the Qianhai Bay project, a government development effort aimed at attracting financial businesses to the area.

It also represents a departure from the Chinese government's efforts at developing secondary and tertiary cities, which might not have garnered a large amount of interest from investors either domestic or foreign, possibly signaling the largest U.S. investment in China in years.

The deal comes at a time when China's major cities are seeing a strikingly high appreciation in value. Just in the last year, some cities have seen residential property values jump more than 100 percent, while values in smaller cities saw increases of about 50 percent, according to Owen Nee of Greenberg Traurig LLP, using former Federal Reserve Chairman Alan Greenspan's term "irrational exuberance" to describe the real estate climate.

China is pouring a tremendous amount of money into its biggest cities, helping to drive up prices and push local investors out. At the same time, the government is looking to develop secondary and tertiary markets. Cities in those markets will likely be at the highest risk of a bubble burst, Nee said.

"One of the telltale factors is that rentals in those cities are incredibly low. They would not in any way justify the prices being asked for those properties," he said. "Unless you're living there, it's not such a great investment."

As a result, foreign investors, including those from the U.S., are sticking closer to major economic centers.

"Buying in rural China, unless one is buying in a soon-to-be boom town or rapidly emerging special economic zone in a geographically favorable area — like Silverstein Properties bought into, just one hour away from Hong Kong — is not such a great investment," Lee said.

Qianhai Bay, where Silverstein made its investment, is located in Shenzhen, a city of about 10 million in the Guangdong Province, close to Hong Kong. This likely puts it at a safe distance from the damage any major change in the market can do, according to Nee, but some experts argue there are other hurdles facing U.S. investors in Chinese real estate.

Regardless of location, profits can be hard to come by if the primary purpose of an investment is not simply for a building to appreciate in value, Mark Mao of Kaufman Dolowich & Voluck LLP said.

The rent that property owners are able to collect does not often match up with the mortgage a new buyer would have to pay for that property, Mao said. Taiwan, where Mao was born, provides a particularly stark example, with a mortgage on a typical 750-square-foot apartment costing between \$5,000 and \$6,000, while the rent roll for the property would likely only be about \$2,100 per month.

There are also disincentives to U.S. investors who are not Asian-Americans and are therefore unfamiliar or uncomfortable with the fact that in China, any property "purchase" is truly just a long-term land lease with the government.

"One of the big deterrents has been, and continues to be, the fact that you have this barrier to entry because if the

government is looking to squeeze you out, you're technically just under a lease," Mao said.

But investments like Silverstein's are expected to continue, particularly in special economic zones like Qianhai Bay, which offer U.S. investors an opportunity to cash in on Chinese residents' flight from the big cities and their skyrocketing prices, experts say.

"Just like in America, it's all about location," Lee said.

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