What's the Deal By Daniel Lesser

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Is it déjà vu all over again?

(The views and opinions expressed in this blog are strictly those of the author.)

Two years ago, direct Chinese investment into the U.S. rose to US$46 billion, while so far this year, roughly US$7.8 billion Chinese capital on a net basis has flowed out of America. Increasing U.S. regulatory oversight and a harsh political spotlight has prompted a broad U.S. selloff. Amid increasing government pressure to limit exposure to foreign investments, several Chinese companies are now attempting to quickly sell off their U.S. commercial real estate assets.

Recent widespread reporting reveals that China-based Anbang Insurance Group is seeking to dispose of a 15-property luxury hotel portfolio acquired from Blackstone for US$6.5 billion in 2016. Blackstone closed on its purchase of the Strategic Hotels & Resorts portfolio for US$6.0 billion roughly three months prior to the acquisition by Anbang, paying an 8% premium over the previous purchase price.

Additional Chinese conglomerates being forced to curtail aggressive foreign investments and, in many cases, divest of recently acquired properties and businesses include: HNA Group, Wanda Group, CEFC China Energy, LeEco and Fosun International. Considering it was these same firms who pushed up prices of many assets, including luxury hotels with robust purchase prices, it is doubtful that these entities will realize proceeds equal to or greater than what was originally paid for a variety of properties.

For those like me who were around during the 1980s, this movie has been seen previously. During that time, Japanese investment in the U.S. soared, particularly into high-profile assets including Rockefeller Center in New York and the Pebble Beach Golf Club in California. Stung by a global economic recession and a relatively weak economy at home, by the early 1990s an asset price bubble had burst, resulting in a collapse of Japanese real estate values and stock market prices. These events provoked a massive selloff of Japanese-owned assets, including U.S. hotels and other commercial real estate.

In my opinion, the recent wave of all types of Chinese investment including institutional funds, state-owned companies, high net worth families and middle-class wage earners in trophy U.S. hotels and office buildings echoes the Japanese boom and bust investments of roughly three decades ago. Both buying sprees occurred under similar circumstances. Like China today, Japan's economy was rapidly expanding in the 1980s. And although Japanese investors then were generally highly leveraged, today's institutional Chinese investors are much less so. However, their finances are murky.

Furthermore, with land being a scarce commodity in their home country, 1980s Japanese investors perceived real estate as long-term holds and were willing to accept significant below-market returns. Similarly, during the recent past, Chinese investors have on numerous occasions paid what are considered to be above-market prices to obtain capital preservation in America.

Will China experience a "lost decade" like the elongated period of economic stagnation that followed the 1990s Japanese asset bubble collapse? In 2015, a crisis was dodged when stock market turmoil and currency devaluations threatened to topple financial markets in Hong Kong and Shanghai.

In retrospect, many believe that Japan worsened its early 1990s crash by tightening monetary policy too quickly. Thus far, although Beijing has avoided Japan's mistake and managed to evade a similar miscalculation, questions remain as to if and how China will deal with its overvalued real estate and financial markets. Only the passage of time will tell.

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