



The Bottom Line

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An article in today's *Wall Street Journal* highlighted the possibility of the Chinese Investment Corporation (CIC)—the sovereign wealth fund responsible for investing roughly \$300 billion (and growing) of China's foreign exchange reserves—investing in U.S. commercial real estate which is already down roughly 35% from its peak. (China established its sovereign wealth fund in 2007 to help manage the nation's \$2 trillion of foreign-exchange reserves and many expect the government to allocate increasing volumes to CIC management to diversify its FX reserve holdings.)

The kicker is that the CIC appears to be eligible to do so under the joint U.S. Treasury-Federal Reserve Public-Private Investment Program (PPIP), which provides a major subsidy to private investors to buy up the toxic assets still clogging bank balance sheets. It is surprising that China's sovereign wealth fund is considered eligible as a *private* investor. It is not surprising that the CIC has been interested for some time in buying distressed property assets, especially mortgage securities backed by commercial real estate. According to the article, the CIC is also interested in "*buying outright ownership interests in buildings.*"

The Chinese have been on a spending spree all year. As I wrote in an August 17th issue of this report, the CIC has said it will actively grasp investment opportunities this year after slowing spending in 2008 because of the global financial crisis. CIC had 87.4% of its global portfolio in cash and cash equivalents at the end of 2008, according to its annual report. It spent \$4.8 billion on new investments last year compared with at least \$8 billion in 2007. This year, the CIC in one month has deployed as much capital as in all of 2008 and might ask the government to let it invest more of the FX reserves.

CIC made its first major investment in a Canadian company in July when it acquired a 17.2% stake in Teck Resources, Canada's largest diversified mining, mineral processing and metallurgical company. Teck also holds a 20% interest in the Fort Hills oilsands project owned by Petro-Canada. By taking an interest in Teck, CIC continued its strategic plan to buy foreign resource companies while they are cheap. (CIC has also made loans in exchange for commodities in the case of Russia and Brazil.) And CIC is not the only Chinese entity that has been investing. Wuhan Iron and Steel (Group) Corporation, and state-owned enterprise in China agreed to invest US\$240 million in Canada's Consolidated Thompson Iron Mines Ltd.'s development in northern Quebec and buy ore from the project once it's operating. Late last month, PetroChina made a \$1.9 billion bid for a majority share of two Alberta oilsands projects—a deal to buy a 60% interest in Athabasca Oil

Sands Corp.'s MacKay River and Dover projects. This has set off the usual flurry of worry about selling Canadian strategic assets to a foreign government.

As the CIC turns its attention to America's damaged real estate assets, there is little information regarding how much the fund is willing to, but the potential firepower of the sovereign fund is huge. Some have suggested that it could be upwards of \$10 billion (or more) by 2014. An important part of the current appeal is the financing offered through PPIP. Under the program, the Treasury will co-invest with funds that buy toxic mortgages. The U.S. government, under the auspices of the Treasury and the Federal Reserve, will make financing available by providing equity capital of up to 100% of the private capital raised by nine designated U.S. fund managers including BlackRock and Invesco, through which the CIC is reportedly working. PPIP limits investments by any single investor to no more than 9.9% of each PPIP fund. This limit was set to assuage concerns that any one investor, like China, could control too much.

Bottom Line: In these troubled times, it seems likely that Congress and the U.S. public will balk at government subsidization of CIC investment in U.S. real estate. This harkens back to the braying associated with the 1980s Japanese purchase of Rockefeller Center and Pebble Beach in Carmel; but, the outcry now could be even louder as those Japanese purchases were not financed with taxpayer dollars.

The CIC this year has invested money in a real-estate trust in Australia and bought an indirect stake in Canary Wharf Group in London. In addition, it has put some money into a global property fund run by Morgan Stanley. Clearly, China will continue to pour billions, if not trillions, of dollars into direct investments around the world. Much of it thus far has been in businesses that produce the commodity products for which China has enormous excess demand. Initially, large component of that investment was in emerging economies or others whose governments were not fussy about foreign-government ownership of strategic assets. Many of them were less-than friendly with the U.S. and happy to do business with China. **But now, even Canada appears to be willing to allow Chinese-government run entities to buy private Canadian businesses. It will be interesting to see if the U.S. government, in its need for capital in these depressed times, will be willing not only to allow the CIC to buy American assets, but to actually sweeten the deal using taxpayer money.**

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