Sovereign wealth funds check-in: Investment strategies in the hotel sector
5. Sovereign wealth funds check-in: Investment strategies in the hotel sector

Introduction: strategic investment is in the air

Sovereign wealth funds (SWFs) fueled by natural resources are facing a period of uncertainty, against a backdrop of low oil and commodity prices. However, in many cases the very reason for setting up these funds was to rationalize management of these resources. One of the roles of SWFs is to cushion the domestic economy from the impact of swings in global commodity prices.

And commodity prices are subject to factors other than just domestic decisions. SWFs were created as a tool to absorb the effects of volatile international commodity prices on the domestic economy. They seek to exploit the good times, such as the super-cycle in global commodity prices between 1999 and 2008 (when oil prices increased from US$10 to US$140 per barrel), to accumulate wealth in an orderly fashion. Most of the SWFs active today date from this period. 66 funds have been created since 2000, compared to the 28 in existence before the new millennium. This equates to growth of 143% in the number of funds, with an injection of US$1.6 trillion into new funds.

But this period came to an end. The situation started to deteriorate rapidly in June 2014, when crude stood at US$115 per barrel. Barrel prices have since fallen in two periods, with an intensity similar to that in 2008 at the height of the Lehman Brothers crisis. In February 2016, the oil price fell below US$30 for the first time since 2004. There are myriad reasons for this affecting both demand and supply, e.g. the development of shale oil in the United States, geopolitical issues between Iran and Saudi Arabia, and economic slowdown in China. This has resulted in an extremely delicate fiscal situation in many oil-producing countries.

In addition to being economically dependent on crude oil, some of the countries affected most, such as Iraq and Libya, are involved in armed conflicts or civil wars. The situation is also particularly critical in Nigeria and Azerbaijan, both of which have requested assistance from the International Monetary Fund. In Latin America, Ecuador and, in particular, Venezuela are facing the serious consequences of dependence on black gold to balance their public finances. However, some Gulf states, such as Kuwait, Qatar and the UAE, with extraordinarily low extraction costs and room for maneuver in debt markets, are facing a less challenging situation.

Saudi Arabia merits individual analysis: it is the world’s second largest producer after the United States and the undisputed leader of the OPEC cartel. It is also the only producer country that can, directly and independently, have some influence in future prices. The reasons that have led this country to run up a US$98 billion public sector deficit while maintaining production (and therefore low prices) involves a complex explanation that is outside the scope of this article.

For the moment, gas prices in the country have increased by 40% following the elimination of subsidies, Aramco is preparing its IPO, and more privatizations and increased controls on discretionary spending by ministries are planned. Saudi Arabia is also considering tapping international markets with an ambitious debt issuance program. This “effort” associated with low oil prices is explained by the strengths of the Saudi economy. These include: low oil extraction costs, low debt (6.7% of GDP) and substantial currency reserves (around US$670 billion, the third highest in the world after China and Japan). Although extraction is expected to remain low (Saudi Arabia has the second largest oil reserves after Venezuela), debt levels and currency reserves could be eaten away over a relatively short period.

The Kingdom’s issuance plan expects targets a debt-to-GDP ratio of 50% in five years, while reserves (managed by the Saudi Arabian Monetary Authority) are being eroded rapidly, falling by more than US$100 billion between September 2014 and August 2015. Saudi Arabia’s strategic decisions over the coming months will determine which way crude oil prices move and how the most important Arab economy’s shaky situation will be handled. One of the most recent decisions is the creation the world’s largest SWF (expanding its Public Investment Fund). This SWF will have control of two giants: Aramco, which will float at least 5% of its share in 2018, and the Sabic chemicals conglomerate. The new Public Investment Fund (“PIF”) will have more than US$2 trillion in assets, twice the size of the current largest SWF, Norway’s Government Pension Fund Global.

Saudi Arabia - like the other Middle Eastern producers with sovereign wealth funds - demonstrates the importance of adopting macroeconomic prudence policies in managing natural resources. This objective will be put to the test now that the good times are over, at least temporarily, and the bad times of low commodity prices have arrived. However, governments use SWFs for a number of reasons, including strategic investment. In addition to reasons of prudence (rules that dictate the accumulation of natural wealth in the good times to avoid inflationary pressures and volatility in public revenues), SWFs are set up to generate higher returns than

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1 Refer to OPEC data at: http://www.opec.org/opec_web/en/data_graphs/330.htm


3 http://www.ft.com/intl/cms/s/0/d1be572a-86fd-11e5-90de-f44762bf9896.html#axzz40EWiZd8u

4 See the Chapter in this Report on “rainy-day funds” and oil prices.
fixed-income instruments, so that the purchasing power of the huge reserves accumulated is not eroded in real terms. These strategic objectives, applied in different ways by different funds, play a crucial role in the current context of volatility and low returns. SWFs have increased their exposure to alternative assets and have entered the real-estate sector, private equity (and even venture capital) funds and invested in infrastructure. Against a backdrop of global uncertainty, SWFs are investing to diversify their revenues sources away from hydrocarbons, in addition to seeking returns. Saudi Arabia, Qatar, Oman and Kuwait receive more than 60% of their public revenues from oil and natural gas.

**Diversifying portfolios and seeking returns: real estate**

One of the strategic priorities for these countries - major oil producers or international trading centers (Singapore, China) - is to establish their position on the global economic map. It should not be forgotten that SWFs are managed by public institutions. This implies that their decisions will reflect the interests of the whichever government is currently in power, having greater or lesser freedom in their actions. Positioning the country on the global map means many things: talent networks, strategic trade and energy distribution hubs, transport, and so on. All of these activities are being developed to a greater or lesser extent by these countries, with the support of their sovereign wealth funds. Examples include the Gulf states competing to establish themselves as the airport hub for routes between Europe and booming Asia, Singapore’s positioning as a major player in international trade and logistics, and China’s use of its SWF to support its economic and commercial expansion with the new Silk Road Fund.

There is one further step in this jockeying for positioning, which mainly affects smaller countries. This is the inclusion of their countries in global tourism networks. As a result of this, sovereign funds have embarked on a fierce struggle to take control of some of the world’s most iconic hotels. The search for returns is undoubtedly the main driving force behind this. Investment in the real-estate sector is nothing new for SWFs, as we will see below.

At year-end 2014, 60% of active SWFs were invested in real estate. Of these, the wealth of 57% is based on hydrocarbons (oil or natural gas); 36% are “non-commodity” funds, such as the China Investment Corporation (CIC) and CIC in Singapore; and the remaining 7% are “commodity” funds other than hydrocarbons (copper, diamonds, etc.).

There are three ways of increasing exposure to the real-estate sector: direct investment, stakes in real estate funds and investment in listed companies that invest in real estate. SWFs prefer direct investment, with 85% using this approach. The funds (Norway’s Government Pension Fund Global, GIC, ADIA in Abu Dhabi, the Qatar Investment Authority and CIC) set up specialist teams (or subsidiaries) to invest in these assets and negotiate directly with the owners. SWFs (64%) are also increasing their exposure to this sector as investors (limited partners, LP) in private equity funds targeting the real-estate sector. Some cases have involved co-investment processes, with the SWFs acting as general partners (GP) together with leading players. Only a third of the funds (32%) follow the third approach: investment in listed companies focused on the sector.

One noteworthy fact is that every single SWF with over US$100 billion of assets under management (AUM) invests in real estate. This shows that the largest funds have the (financial, human and management) resources to invest in the highly complicated real-estate sector. Diversification is another important factor: in 2011, the Norwegian GPFG fund - which had previously refused to “complicate” its portfolio beyond fixed income and equity instruments - decided to create a subsidiary in Luxemburg (Norges Bank Real Estate Management) to begin investing in real estate.

The investment mandate was extended beyond Europe in 2013, and the fund is now investing heavily in the North American market. The two main motivations for Norges Bank Investment Management (NBIM, the public manager of the Norwegian SWF) are diversification and protection against inflation (income is usually indexed to price levels). This investment giant has grown from a new entrant into a major player in the sector in a very short period of time. To make up for its lack of experience, NBIM has entered into agreements with some of the US’s most important real-estate asset managers, namely: TIAA-CREF (to purchase office buildings in Washington, New York and Boston), which was its first ally; Trinity Wall Street Church (offices in New York); Prudential (to acquire the emblematic 11 Times Square building in New York); Prologis US (the agreement with which includes 400 logistics hubs); Boston Properties; and MetLife (with emblematic buildings in Boston, New York and San Francisco). NBIM has made a total of 431 investments, worth over US$10 billion, making it one of the largest foreign investors in US real estate.

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Norway is not alone in being attracted by the US market, as the vast majority of SWFs are also investing there: 90% choose the US as a destination for real-estate investment. This compares to 76% in Asia, 65% in the Middle East, 50% in Australasia and just 29% in Europe. As we will see, the latter figure shows that few funds are taking a chance on the European market. Europe and the US have two common features: they are destinations for real-estate investment, and they have few national SWFs. In comparison, the numbers for Asia and the Middle East are much higher, partly because SWFs in these regions are comfortable co-investing in real-estate assets and developments with local partners, which they know well, and are sometimes also managed by public companies. Even so, the numbers for Europe remain low in comparison with the US, and show how much more needs to be done to attract more SWFs. In Norway, NBIM works with regional partners such as AXA and Generali in France, and Pollen Estate and The Crown Estate (retail) in the UK. NBIM has also formed an alliance with Prologis (Europe) to increase its exposure in the logistics segment across multiple European countries, where it already has nearly 200 assets. The Norwegian fund’s total exposure to European real estate is US$10 billion, and this is growing more slowly on average than its investment in the US (around 15% between 2013 and 2015).8

The hotel industry: a strategic destination for an increasing number of funds

According to JLL Research, global investment in hotels jumped 50% in 2015 to US$85 billion. There are two main reasons for this increase: cross-border investment and single asset transactions. More than 50 individual hotels sold for over US$600 thousand per room last year. Activity in 2016 is expected to be more measured, with fewer buyers of trophy properties, but will still show the interest in a sector that is consolidating its appeal.

The hotel industry is experiencing an unprecedented boom. In 2015, large hotel chains were regular cover stars in many media outlets, with some of the most significant deals involving single-asset acquisitions. The biggest deal of the year was Blackstone’s US$6 billion purchase of Strategic Hotels & Resorts. The US was the most significant market. One of biggest investment stories was the possible merger of Marriott International with Starwood Hotels & Resorts. The US$12.2 billion acquisition proposed by Marriott would create the world’s largest hotel group. Marriott-Starwood would have more than 5,500 hotels and 30 brands, including Westin, Sheraton, Ritz Carlton, St. Regis, Renaissance, Courtyard, AC Hotels and Fairfield Inn & Suites. A few weeks later, China’s Anbang Insurance Corp, which bought New York’s legendary Waldorf Astoria for US$2 billion in 2014, increased the bid for Starwood to US$14 billion in an all-cash deal.9 And while it still remains to be seen which will be the hotel deal of the year, the competition for the new group will be intense: competitors in this market, which has been extraordinarily active since the crisis, include the Americans, such as Hilton (bought by Blackstone in 2007 for US$26 billion), the British, such as InterContinental (IHG), and the French, such as Accor10. But the competition is not restricted to traditional rivals.

The whole sector is currently threatened by a single company: Airbnb. This startup was created in San Francisco in August 2008, allowing users to rent out their flats and homes privately. It is currently valued at US$25.5 billion11, beating the stock market valuation of Hilton US$20.1 billion, and only slightly below the combined value of Wyndham (US$8.4 billion), Choice Hotels (US$2.9 billion), IHG (US$6.4 billion) and Accor (US$8.9 billion).

Airbnb had sales of US$900 million in 2015. It is currently offering 1.5 million listings in 34 thousand cities in 190 countries. Despite managing no properties of its own, this startup is threatening an entire industry, just as Uber is threatening the transport sector and Alibaba the retail sector.8 SWFs are long-term investors in both cases. They have taken positions in the capital of these companies searching for significant present and future returns from the disruption they represent. The funds are betting on different areas: for Qatar Investment Authority it is Uber; while CIC and Temasek have invested in Didi Chuxing, Uber’s Chinese competitor; CIC has also invested in GrabTaxi, Uber’s competitor in Singapore; GIC has taken a stake in Ola, the local startup in India. No sovereign investors have yet declared an investment in Airbnb, but the Norwegian fund, and its US partner TIAA-CREF, recently acquired the building in San Francisco that is home to the headquarters of the Californian startup12.

For more information on startups and their appeal for long-term investors, see the 2015 Report: “The Shift” (Santiso and Schena & Chaturvedi). Malaysia’s Khazanah, the China Investment Corporation and Singapore’s Temasek invested in Alibaba prior to its stock market floatation. See: http://www.ft.com/intl/cms/s/0/173b8bba-9bea-11e4-b6cc-00144feabdc0.html#axzz42Wfp7ttu

Details of the deal are available at: http://fortune.com/2016/03/31/starwood-anbang-marriott-2/

A list of startups valued at more than US$1 billion is available at: http://graphics.wsj.com/billion-dollar-club/

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13 The story is available at: http://lucidice.morningstar.com/NewSocialize/forums/t/352823.aspx

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9 Details of the deal are available at: http://fortune.com/2016/03/31/starwood-anbang-marriott-2/

10 Information on the world’s largest hotel groups is available at: http://www.statista.com/statistics/245684/number-of-hotels-of-international-hotel-groups/

11 A list of startups valued at more than US$1 billion is available at: http://graphics.wsj.com/billion-dollar-club/

12 For more information on startups and their appeal for long-term investors, see the 2015 Report: “The Shift” (Santiso and Schena & Chaturvedi). Malaysia’s Khazanah, the China Investment Corporation and Singapore’s Temasek invested in Alibaba prior to its stock market floatation. See: http://www.ft.com/intl/cms/s/0/173b8bba-9bea-11e4-b6cc-00144feabdc0.html#axzz42Wfp7ttu

13 The story is available at: http://lucidice.morningstar.com/NewSocialize/forums/t/352823.aspx
Sovereign wealth fund investment in the hotel sector

Despite crude price trends, investors from the Middle East and other SWFs in Asia and Singapore are continuing to increase their investment in hotels. They appear to be continuing to follow an international approach, given the limited supply of domestic assets. Sovereign wealth funds injected more than US$71 billion into the hotel sector in 2015, representing 8.4% of global hotel investment. Forecasts for 2016 point to a similar pattern and similar figures.

International hotel investment is still hitting all-time highs, driven by large institutional investors and the family offices of some of the largest fortunes on the planet14.

The following Chart and Table 1 are limited to sovereign wealth funds, showing the main deals in the hotel sector in 2015. In total, SWFs were involved in 18 deals - 4 sales and, in particular, 14 purchases - all of which exceeded US$20 million. SWFs were involved in single-asset transactions (10), asset portfolios (7) and one stock market floatation.

As we explain below, the deals involving sales, in some cases (e.g. Qatar Investment Authority in the sale of FRHI or GIC Real Estate in the sale of Hyatt Regency La Jolla) involved an injection of liquidity for the funds, which they then reinvested in the real-estate and hotel sector, as we can see from the purchases that followed the sales.

Given its importance for the sector and its interest in highly visible, renowned assets (trophy assets), the Qatar Investment Authority (QIA) merits careful analysis, as it has a wide range of investors and vehicles that are difficult to track. Through various subsidiaries, QIA has invested around US$4.0 billion in luxury hotel assets in Paris, London and Rome. This accounted for 56% of total investment of all sovereign wealth funds in 2015, demonstrating the importance of the European hotel sector for SWFs.

The year's most important deal in the hotel sector involved Constellation Hotels Holding, a finance company headquartered in Luxemburg, and wholly owned by Qatar Holding. Constellation Hotels acquired the Maybourne Hotels Group in May 2015, purchasing the 65% of the group controlled by the Barclay brothers and the 35% controlled by Ireland’s Paddy McMillen. Maybourne Hotels comprises three historic luxury hotels in the UK capital: Claridge’s, The Berkeley and The Connaught. This deal was completed after nearly four years of legal battles between the brothers and the Irish millionaire, concluding with another victory for the Qatari negotiators15, as occurred with Xstrata and the acquisition of land in Canary Wharf. This huge acquisition made Qatar once again the largest investor in trophy assets worldwide, with iconic investments such as Harrods and the Shard skyscraper in London.

The second largest deal of the year was the sale of the FRHI’s hotel portfolio to French hotel group Accor for US$2.9 billion. FRHI Holding owns hotel brands such as Raffles, the Fairmont and Swissôtel, managing 155 hotels in 30 countries. It has a marked bias towards the USA, where occupancy rates and revenue per available room (RevPar) are at their highest since 2007. Its assets include the legendary Savoy in London, Raffles in Singapore and the Plaza in New York. FRHI controlling shareholders were Qatar Investment Authority, Kingdom Holdings (the investment vehicle of the Saudi prince Alwaleed bin Talal) and Oxford Properties (the real-estate investment subsidiary of OMERS, the active pension fund for Ontario, Canada).

As indicated previously, sales involving sovereign wealth funds were not part of an exit strategy from the hotel sector, but rather a move to reorganize their investment strategy. A case in point is the Qatar Investment Authority’s involvement in the sale of FRHI. The sale did not imply any waning interest in the sector. In fact, as part of the deal, QIA swapped shares in FRHI for 5% of the shares of Accor, giving it two seats on the board of directors of Europe’s largest hotel group. Abdullah bin Mohammed Al Thani, CEO of QIA and member of the Qatari royal family, said that the deal would enable QIA to ramp up its operations in the hotel and real-estate sectors.

And a sovereign wealth fund was once again on the sales side of one of the biggest deals of the year in the sector. Once again, this was Qatar. Although at a higher level, Qatar also played a fundamental role in the acquisition of Glencore and Xstrata in 2013. With its seats on Accor’s board, QIA is in an excellent position to learn about and exploit the sector through one of the world’s 10 largest hotel groups16.

Qatar is continuing its strategy of investing in singular, luxury hotels: Katara Hospitality (the hotel management, development and investment subsidiary of Qatar Holding) bought the iconic

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15 The detailed story is in the Wall Street Journal at: http://www.nytimes.com/2015/04/24/business/international/battle-for-claridges-ends-in-sale-to-qatari-group.html?_r=0
16 The deal described by Accor during the announcement is available at: http://www.accorhotels-group.com/fileadmin/user_upload/Contenus_Accor/Finance/Presse/accor/presse/2015/10/20151009_pr_accorhotels_fri.pdf and the interest of the CEO in adding two of the five most sophisticated (global luxury owners in the world into Accor’s capital structure is explained at: http://www.ft.com/intl/cms/s/0/2d82723e-4bcd-4812-b5d6-489252099f81.html#axzz452o47ZdI

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<table>
<thead>
<tr>
<th>Asset acquired</th>
<th>Volume (US$ million)</th>
<th>Buyer</th>
<th>Seller</th>
<th>Month</th>
<th>Location</th>
</tr>
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<tbody>
<tr>
<td>Maybourne Hotel Group (Claridge's, The Berkeley and The Connaught)</td>
<td>3,367.7</td>
<td>Constellation Hotels (Qatar Investment Authority)</td>
<td>The Barclay brothers; Paddy McKillen</td>
<td>May</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>FRHI Holdings Limited</td>
<td>2,897.4</td>
<td>Accor S.A.</td>
<td>Oxford Properties Group, Inc.; Kingdom Holdings Company; Qatar Investment Authority</td>
<td>September*</td>
<td>Cayman Islands</td>
</tr>
<tr>
<td>Portfolio of hotels in Hong Kong: Grand Hyatt Hong Kong, Renaissance Harbour View, Hyatt Regency TST</td>
<td>1,411.9</td>
<td>Abu Dhabi Investment Authority &amp; Mega Fortune Company Ltd.</td>
<td>Westmont Hospitality Group, Inc.; U Billing Bank Ireland Limited; Avenirus Capital Partners; Oman Investment Fund; Mount Kellett Capital Management LP</td>
<td>April</td>
<td>Hong Kong</td>
</tr>
<tr>
<td>Juns Inn Group Ltd.</td>
<td>1,042.3</td>
<td>Lone Star Funds</td>
<td>Marriott International</td>
<td>January</td>
<td>Ireland</td>
</tr>
<tr>
<td>The London NYC</td>
<td>382.0</td>
<td>Abu Dhabi Investment Authority</td>
<td>The Blackstone Group LP</td>
<td>November</td>
<td>USA</td>
</tr>
<tr>
<td>Portfolio of Hilton hotels in Germany (2), Paris, Zurich, Strasbourg, Luxembourg and Barcelona</td>
<td>380.0</td>
<td>Oman Investment Fund</td>
<td>Westmont Hospitality Group, Inc.; The Baupost Group, LLC</td>
<td>December</td>
<td>EU</td>
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<tr>
<td>New York Edition</td>
<td>372.3</td>
<td>Abu Dhabi Investment Authority</td>
<td>Marriott International</td>
<td>April</td>
<td>USA</td>
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<tr>
<td>InterContinental Paris – Le Grand</td>
<td>360.9</td>
<td>Constellation Hotels (Qatar Investment Authority)</td>
<td>InterContinental Hotels Group</td>
<td>June</td>
<td>France</td>
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<tr>
<td>Westin Excelsior Rome</td>
<td>251.0</td>
<td>Katara Hospitality (QIA)</td>
<td>Starwood Hotels &amp; Resorts</td>
<td>September</td>
<td>Italy</td>
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<tr>
<td>Miami Beach Edition</td>
<td>230.0</td>
<td>Abu Dhabi Investment Authority</td>
<td>Marriott International</td>
<td>February</td>
<td>USA</td>
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<td>InterContinental Hong Kong</td>
<td>200.0*</td>
<td>Korea Investment Corporation; Gaw Capital; others.</td>
<td>InterContinental Hotels Group</td>
<td>May</td>
<td>Hong Kong</td>
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<td>Hyatt Regency La Jolla in Aventine</td>
<td>118.0</td>
<td>Walton Street Capital, L.L.C.; JMA Ventures Inc.</td>
<td>Strategic Hotel Funding, LLC; CIC Real Estate Pte Ltd.</td>
<td>April</td>
<td>USA</td>
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<tr>
<td>Renaissance Raleigh North Hills Hotel</td>
<td>79.9</td>
<td>Abu Dhabi Investment Authority</td>
<td>Concord-Hospitaility Enterprises Company; Kane Realty Corporation</td>
<td>May</td>
<td>USA</td>
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<td>Paris Marriott Opera Ambassador</td>
<td>54.0*</td>
<td>State General Reserve Fund (Oman)</td>
<td>-</td>
<td>August</td>
<td>France</td>
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<tr>
<td>Kim Lien Tourism Joint Stock Company</td>
<td>44.4</td>
<td>-</td>
<td>State Capital Investment Corporation (Vietnam)</td>
<td>November</td>
<td>Vietnam</td>
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<tr>
<td>Hyatt House Raleigh North Hills Hotel</td>
<td>23.0</td>
<td>Abu Dhabi Investment Authority</td>
<td>Concord-Hospitaility Enterprises Company; Kane Realty Corporation</td>
<td>May</td>
<td>USA</td>
</tr>
<tr>
<td>Portfolio of hotels in Sudan</td>
<td>57%</td>
<td>Kuwait Investment Authority</td>
<td>Sudanese-Kuwaiti Hotels Company (Government of Sudan)</td>
<td>March</td>
<td>Sudan</td>
</tr>
<tr>
<td>W Washington DC</td>
<td>100%</td>
<td>Investment Corporation of Dubai</td>
<td>Istithmar Hotels</td>
<td>April</td>
<td>USA</td>
</tr>
<tr>
<td>Mandarin Oriental NYC</td>
<td>68%</td>
<td>-</td>
<td></td>
<td></td>
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<tr>
<td>One&amp;Only Cape Town</td>
<td>30%</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (purchases &amp; sales)</td>
<td>11,215</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (purchases by sovereign wealth funds)</td>
<td>7,113**</td>
<td></td>
<td></td>
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</tbody>
</table>

Source: The author, with data from Capital IQ, Sovereign Wealth Center and the funds.
* Own estimate
** Sum of investments (purchases) by sovereign wealth funds.
Westin Excelsior in Rome in 2015. This was the latest in a series of investments that has built up a portfolio of 35 luxury hotels worldwide, following the acquisition of the Le Grand hotel in Paris in 2014 from the Intercontinental Hotel Group (IHG) for €330 million. A year earlier, it bought the Park Lane hotel in London from IHG for €472 million. The divestment strategy of larger hotel groups to bolster their capital is opening the door for fresh investment in single assets. In 2013, Katara gained control of five IHG hotels, in Cannes, Rome, Amsterdam, Frankfurt, and Madrid.

ADIA has also been an active buyer. The Abu Dhabi giant was involved in six deals in 2015 - five acting on its own - investing US$2.76 billion in hotel assets in Hong Kong, France and the US. The deal in Hong Kong was noteworthy, as it was ADIA’s largest investment in China’s special administrative region. This involved the acquisition of 50% of a holding company controlled by Chinese magnate Cheng Yu-tung, the owner of New World Development. This gave ADIA control of 50% of three luxury hotels in Hong Kong. The mass influx of tourists from continental China gives this market enormous medium- and long-term potential. A few months earlier, Qatar, through QIA, bought 20% of the famous Sogo shopping mall, which is highly popular among tourists from continental China. This business is similar to Harrods in London, which is also owned by the Qataris. Once again, the seller was the Cheng family, one of the most important in Hong Kong²⁰. ADIA’s close cooperation with Marriott International is also noteworthy. In 2013, ADIA undertook to buy three hotels under development to support the expansion of its new Edition brand. Two years later, two of these acquisitions were completed, with the purchase of hotels in Paris and New York. In New York, ADIA has also positioned SWFs in the purchase of trophy assets, with the acquisition of the historic MetLife Tower, and its famous clock, at 5 Madison Avenue.

The Oman Investment Fund has also been very active, investing US$380 million in the purchase of a portfolio of seven Hilton hotels in Europe. The Omani fund is the owner of a joint venture between US hedge fund Baupost and Canadian hotel operator Westmont Hospitality Group (WHG), through which it acquired seven Hilton hotels for US$380 million in the purchase of a portfolio of seven Hilton hotels for €330 million. In 2014 from the Intercontinental Hotel Group (IHG) for €330 million. A year earlier, it bought the Park Lane hotel in London from IHG for €472 million. The divestment strategy of larger hotel groups to bolster their capital is opening the door for fresh investment in single assets. In 2013, Katara gained control of five IHG hotels, in Cannes, Rome, Amsterdam, Frankfurt, and Madrid.

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Korea Investment Corporation led a deal to acquire the InterContinental in Hong Kong, with the private equity group Cow Capital as a local partner. This iconic building was sold by IHG, which is continuing to manage it. The deal was valued at US$938 million, split evenly between equity and debt with local financiers. KIC is continuing its commitment to investment in real estate, having acquired a shopping mall in Berlin and, more recently (2016), taken a controlling stake in six luxury hotels in the USA. KIC’s main interest in both cases is to diversify its portfolio, following in the footsteps of the Norwegian fund to which it is often compared because of its conservative investment profile.

Meanwhile, another Omani fund, the State General Reserve Fund, acquired 90% of the Marriott Opera Ambassador in Paris. The price paid has not been disclosed, but it is likely to be around US$60 million (in line with the price paid for other Marriott hotels with similar characteristics, at an estimated $200 thousand per room). There is an interesting connection in this August 2015 deal: the remaining 10% of the hotel remained in the hands of Canada’s WHG group²³, which sold its portfolio of Hilton hotels to OIF - the other Omani sovereign wealth fund - a few months later. The connection between the two deals displays a degree of coordination in the activities of the Sultanate’s two SWFs, revealing the nature of these sovereign funds, which share the same owner and the same objectives aligned with national strategy.

Finally, deals involving the Kuwait Investment Authority and the Investment Corporation of Dubai (ICD) have put Africa on the global hotel map. These involved two transactions with hotels in Sudan and South Africa. KIA bought 51% of the joint venture it had set up with the government of Sudan. This collaboration dates back to 1972, and has served to boost the country’s tourism industry. The Hilton chain abandoned its operations in Sudan in 2007, with the joint venture taking control of the hotels. As a result of this deal, KIA now controls 100% of the assets. Meanwhile, ICD acquired ownership and control of various hotel assets managed by the Emirate’s other major investment group, Dubai World. Dubai is the
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Source: Author’s elaboration from Capital IQ and various sources. *Author’s estimation.

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MAYBOURNE HOTEL GROUP (Claridge’s, The Berkeley y The Connaught)
54%
251
3,368

HILTON’S HOTEL PORTFOLIO (Germany (2), Paris, Zurich, Strasbourg, Luxembourg and Barcelona)
380

SUDAN’S HOTEL PORTFOLIO
51%

ONE&ONLY CAPE TOWN
30%

JURYS INN GROUP LTD.
Westmont Hospitality Group, Inc.; Ulster Bank Ireland Limited; Avestus Capital Partners; Mount Kellett Capital Management LP

WESTIN EXCELSIOR ROME

INTERCONTINENTAL PARIS - LE GRAND

MAYBOURNE HOTEL GROUP

PARIS MARriott OPERA AMBASSADOR

HILTON’S HOTEL PORTFOLIO

Mega Fortune Company Ltd.

KIM LIEN TOURISM JOINT STOCK COMPANY

ONE&ONLY CAPE TOWN

HONG KONG’S HOTEL PORTFOLIO (Grand Hyatt Hong Kong, Renaissance Harbour View, Hyatt Regency TST)

Gaw Capital

INTERNATIONAL PARIS - LE GRAND

Qatar Investment Authority
2,897

Oman Investment Fund
1,042

GIC Real Estate Pte Ltd.
118

State Capital Investment Corporation
44

GIC

TOTAL
11,215

ACQUISITIONS
7,113

SALES
4,102

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financial capital of the Middle East, not to mention a regional power in the real-estate sector. Based on this knowledge, it is continuing to develop this long-term relationship with the sector. For instance, the Cape Town hotel was bought from Kerzner International Holdings, an international developer with which ICD is developing a new luxury resort in Palm Jumeirah, valued at US$1.5 billion. Once again, these equity deals are strategic national economic development projects.

**Trends and conclusions**

The most significant deals over the last year reveal a number of trends. First, a continuation of the divestment policy of large hotel groups (an “asset-light” strategy). Global hotel chains have been reducing their hotel ownership for decades, concentrating instead on management. To illustrate, five years ago IHG only owned 1% of its rooms, Marriott 2%, Starwood 7% and Hyatt 17%. The groups that have followed this asset-light strategy have reaped higher profits, reduced revenue volatility and, as a result, increased the value of their companies. Second, in relation to the specific investments of sovereign funds, some countries have improved their international positions by acquiring hotels and hotel brands. In the case of Katara Hospitality (Qatar Holding), it is interesting to note the alignment of objectives between the Qatari government and its hotel-investment arm. Katara has said that it is “proud of its role in the national economic plan to attract the best [hotel] brands to Qatar.” This attraction and positioning function is typical of sovereign wealth funds seeking a strategic national interest, more than financial returns on the investment.

Third, in addition to positioning, the hotel sector is a source of economic diversification and knowhow. The possibility of interacting with major international players enables the acquisition of management models that can then be replicated in the domestic economy and abroad. Katara Hospitality has been in the industry for over 45 years. It currently has a portfolio of 35 hotels, owning 22 hotels in 10 countries, operating four under the Murwab Hotel Group brand in Doha and developing nine projects in three countries. These 35 hotels that are already in operation or under development will have swollen to 60 within 10 years. Future hotel developments will be possible because of the experience gained in recent years through its relationship with brands such as Raffles, Sheraton, Ritz-Carlton and Westin. Katara is now getting more involved in developing its own hotel products, including one on Lake Lucerne in Switzerland and the transformation of an old palace in Morocco.

Fourth, the hotel sector enables institutional investors to diversify their investment portfolios. The asset-light strategy means that ownership of many hotels has passed to large investors: institutional investors (including pension and sovereign wealth funds) are the largest buyers of single assets, while private equity groups are usually the purchasers of entire portfolios of hotel assets. With interest rates at such low levels and the outlook for increases still very weak in the US due to uncertainty over the global economic recovery, the search for returns in the real-estate sector seems to be a safe haven for institutional investors. SWFs are well aware of this trend.

Last, but not least, hotels are linked to international and domestic tourist movements. Global tourism is a dynamic sector that has been experiencing exponential growth for decades.

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21 For more information on Katara Hospitality visit: www.katarahospitality.com
Box 1

Sovereign wealth funds in the hotel industry in Spain

Spain is a global power in tourism. It received 68.2 million international tourists in 2015, and this figure is expected to rise to more than 70 million in 2016. Spain is ranked number three in the world by tourist arrivals and receipts (US$56.5 billion in 2015). This massive flow of visitors has enabled the country to develop a robust hotel industry. Hotels and hotel chains in Spain are attractive assets for international institutional investors, including sovereign wealth funds. Since 2013, SWFs have invested at least €300 million in Spanish hotel assets. Moreover, revenues per room – the metric most widely used in the sector – still have plenty of scope for growth in many hotels in Spain, boding well for more deals in the coming years.

One of the most significant deals took place in 2013, when Qatari Diar, a QIA subsidiary, bought Hotel W in Barcelona from a consortium comprising ACS, CHL, Comsa Ente and BCN Godia, for US$200 million. In 2014, Katara Hospitality, another QIA subsidiary involved in investing in hotel assets, bought five InterContinental hotels in Europe. These included an asset on the Castellana in Madrid for €60 million purchased from its previous owner, which was also Qatari.

The most important deal in 2015 was also in Barcelona, with the €60 million sale of the Hilton hotel to the Oman Investment Fund. This was the first real-estate deal involving this Omani fund in Spain.

In addition to SWFs, other Gulf-state investors have bought luxury hotel assets in Spain, but even these investors are in some way related to sovereign wealth funds. For example, in 2014 a public-sector investor representing the Qatari armed forces (QAMPI) bought the Renaissance hotel in Barcelona for €78.5 million. The hotel had been owned by the US Marriott brand since it bought 50% of the Spanish AC Hotels group in 2011. In 2015, another luxury asset in Madrid was sold when the private Saudi Olayan conglomerate acquired Madrid’s historic Ritz hotel, in a joint venture with Mandarin Oriental, for €130 million. In 2016, Turkey’s Dogus group, in partnership with Spain’s BBVA bank, bought the emblematic five-star Villa Magna hotel in Madrid from Portugal’s Queiroz Pereira family for €180 million. This latter deal is noteworthy because this effectively priced its 150 rooms at €1.2 million, the highest rate in the Spanish hotel sector.

Interest on the part of SWFs in the Spanish hotel sector is hardly new. In 2006, an investment conglomerate including Singapore’s GIC bought the Arts hotel in Barcelona for €417 million. The Arts hotel held the record for the “most expensive hotel per room” for 10 years, until the recent purchase of the Villa Magna.

Barceló Hotels has also been working with sovereign wealth funds for more than a decade, through Tomescuview European Holdings, a subsidiary of ADIA, the largest sovereign fund in Abu Dhabi. This group was the investment partner of Playa Hotels and Resorts, an investment vehicle founded in 2006 by what was then the Barceló Group, to spearhead the acquisition of hotel assets in Mexico, the Caribbean and Latin America.

There is a particular bias in sovereign wealth funds that regularly acquire real-estate assets in prime locations, towards high spending tourism in urban locations in major European and US cities. Being well positioned in these mature markets, SWFs are now building their exposure to emerging markets, knowing that there is a clear trend: tourist arrivals in emerging destinations are expected to grow at twice the rate of traditional destinations between 2010 and 2030. The market share of emerging destinations will also increase to 57% of arrivals over this period. The deals we have seen by sovereign wealth funds in Hong Kong and Vietnam reflect this trend.

More deals can therefore be expected in these markets: in 2014, tourist arrivals in the Americas increased by 8% (with Mexico experiencing a significant surge), while Asia-Pacific and Middle East arrivals grew by 5% and Europe arrivals by 3%. This trend continued through 2015, with a slowdown in the Middle East due to geopolitical instability and terrorism in the region.

This trend will be enhanced over the medium term for one single reason: China. China is now the top tourism source market by expenditure: Chinese tourists spent US$165 billion in 2014, compared to US tourists spending US$111 billion and German tourists US$92 billion. As the figures illustrate, four out of five tourist destinations are within the same region: this explains spending on destinations such as Hong Kong and Macao (which for these purposes is classified as international tourism from China). Other countries poised to benefit from this burgeoning Chinese tourism include Myanmar, Malaysia and Cambodia to the south east, India and Sri Lanka to the south, and Japan and South Korea to the north east. Political unrest is the main reason for the 7% fall experienced by Thailand, a traditional destination for Europeans and North Americans.

Traditional destinations, such as France, the United States and Spain - the top 3 by tourist arrivals - are now competing with emerging markets such as China (4), Turkey (7), Russia (9) and Mexico (10). International tourism receipts show that some emerging destinations have high tourist spending: China (3), Macao (5), Thailand (9) and Hong Kong (10).

It would not come as a surprise if Chinese government companies and SWFs became involved in this global strategy of capturing their own international tourist assets. The purchase by the HNA Group (a

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private conglomerate) of Carlson Hotels and Anbang’s deal to take control of Starwood (where it “competed” with the China’s CIC sovereign wealth fund) both follow this approach: seeking to capture returns generated by global Chinese tourism. In the case of HNA, in addition to controlling Spain’s NH Hotels, it also owns the specialist cargo-handler Swissport since 2015, and Hainan Airlines, the China’s fourth largest airline. Will we see a Chinese hotel-investment arm linked to CIC? Or will it continue its strategy of selective support for Chinese companies in their global adventures? Only time will tell which of these two strategies China will follow.

There are also myriad examples relating to the Middle East and Africa. Perhaps the most remarkable case is Morocco, which has created its own SWF for developing the tourism sector (similarly to the deal mentioned above by Katara in the country). Morocco set up the Moroccan Fund for Tourism Development (FMDT, for the French acronym) in 2011, as part of its Vision 2020 project. Its strategic objective is to develop new destinations and guarantee the funding required to develop the tourism infrastructure needed to host 20 million tourists by 2020 (up from 10.3 million in 2014), taking it into the global top 20. In addition to providing this finance, FMDT also acts as a catalyst for international investment in tourism. In 2011, it coordinated the creation of Wessal Capital, a unique vehicle owned by five sovereign wealth funds, which have earmarked €2.5 billion to foster the country’s tourist sector. Each of the funds - Al Aijal Holding (Kuwait Investment Authority), Qatar Holding (Qatar Investment Authority), Public Investment Fund (Saudi Arabia), Aabar (owner of the Emirates sovereign fund IPIC) and Morocco’s FMDT - contributed €500 million. Among the most recent developments is the €530 million Wessal Casa-Port,22 which includes the refurbishment of historic buildings in Casablanca and a total redesign of the area with the construction of a new cruise-liner terminal, a marina and a number of hotels.

To conclude, the hotel sector is an important investment destination for sovereign wealth funds. First, the sector closely reflects trends in international tourism, helping to anticipate emerging medium- and long-term socio-demographic trends (e.g. rising middle classes, new poles of economic activity in Asia). Second, purchasing buildings can protect the value of investments by indexing rents to inflation. Third, the medium-term returns offered by such buildings in emerging markets that are not yet saturated are an increasingly attractive investment option, at a time of low interest rates and stock market volatility. Fourth, the visibility and international positioning achieved by aligning a country’s brand with prestigious “western” locations and institutions enhances the legitimacy of the governments of countries with sovereign wealth funds, most of which are “emerging economies”. Finally, the useful lives of these investments explains their interest to SWFs, which have long-term investment mandates and need to find assets that combine returns with moderate risk.

22 For more details visit: http://www.thenational.ae/business/property/uae-backed-wessal-capital-begins-work-on-portion-of-530m-casablanca-revamp