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SWF Investment 2013: The Continuing Quest for Quality Deal Flow

3. SWF Investment 2013: The Continuing Quest for Quality Deal Flow

2013 marked yet another year of steady advancement in both the number and aggregate size of sovereign wealth funds globally. Including the watershed year of 2006 when 10 new funds were established, some 25 entities have been created primarily in emerging economies[1]. Among those 25, ten funds were established in Africa, which today is home to 15 SWFs. Asset growth has likewise expanded in the intervening years, by some accounts more than doubling to current estimates of approximately $6 trillion. This brief reflection on the rapid expansion of SWFs as a class of global institutional investor is important. While it may mask the substantial differences in the size and scale of SWFs, it helps to inform the challenges of managing large and expanding pools of institutional capital and the continuing quest for quality deal flow. These challenges will become more pronounced as the average size of SWFs continues to expand and along with it competition to efficiently deploy capital in scale.

Definition and methodology

We begin our discussion with a brief, but cautionary note on definition and methodology, which, we believe, has broader applicability to research into the investment activities of SWFs. First, definitions matter[2]. In this context, our definition of "sovereign wealth fund" is broad in scope and includes what are commonly referred to as stabilization, wealth, development, and pension reserve funds. Next, our research on investment activity, described and analyzed in this chapter, is focused on those direct investments by SWFs conducted in private versus public markets, i.e. what might be described as "private equity". We do not, however, exclude transactions in which SWFs provide debt capital. Also, our research attempts to isolate the direct contribution of a SWF to a transaction. This includes estimates of capital directly contributed or earmarked for the deal. Because deal amounts or direct SWF contributions are frequently unreported or refer to capital commitments versus invested amounts, in-year estimates of SWF DFI can vary widely among researchers.

Large fund structures and concentration themes tend to dominate our analysis. This is a naturally occurring bias in the data. Thus, for 2013 we identified over 160 confirmed transactions involving SWFs expectedly concentrated among the largest funds. Earlier patterns of concentration in such industries as financial services and real estate likewise continued from prior years. With respect to investment behavior, a pattern has emerged suggesting that the average size of SWF contributions to individual transactions may be rising after several years in decline.

Global deals analysis

As has been well-documented[3], the years in the immediate aftermath of the financial crisis saw large SWFs investments directed to the financial sector. These infusions were driven by the need for liquidity and prompt recapitalization in several large global banks – both domestic and foreign – to the investing funds. During the intervening period – 2010-2012 – relatively smaller deals transactions were completed with listed non-financial firms including AMD, Nova Chemicals, Daimler, Porsche, CEPSA, Frac Tech, and Siemens. SWF investment in these companies was often directed to facilitate further corporate expansion in the SWF's home country whether through the build-out of increased manufacturing capacity or to secure access to a steady supply of raw materials.

More recently, we observe sizeable SWF investments directed to large developmental projects, including townships, industrial zones, and key infrastructure, or to the development of strategic assets, such as natural resource, including extraction and refining. Many of these investments represent capital commitments that will be deployed over the coming five years, i.e. through project construction. They are typically driven by MoU signed by the state and a private company, or between two states, wherein the SWF plays key roles not only as a source of funding, but also to facilitate deal origination and structuring. Two examples will serve to illustrate.

In 2013, the largest foreign acquisitions by SWFs were two deals of $5 billion each. Both the deals involved a MoU signed between the SWF and the host national government. In the first, Mubadala signed an agreement with the Guinean government to build bauxite and an aluminum refinery in Guinea. In this deal $1 billion was earmarked to build infrastructure to extract and export bauxite, while additional $4 billion will be utilized to build an aluminum refinery and port. Similarly, QIA agreed to invest $5 billion in the Pengerang Integrated Petroleum Complex in the southern state of Johor, in Malaysia. Both transactions involve capital commitments to be made over a period of three to four years.

Focusing specifically on the largest SWF deals of 2013, of the top five, three deals where in sectors related to real estate and construction while 2 were in natural resources.

[1] As both the definition and count of SWFs global remains a topic of considerable debate, it is difficult to definitely scale the impact of entity growth. Nonetheless defensible estimates suggest that.
[2] Javier Capapé and Tomás Guerrero. 2013. "More layers than an onion: Looking for a definition of Sovereign Wealth Funds" SovereigNET Research Paper, The Fletcher School, Tufts University, Boston, MA.

[3] See also chapter 7 on Financial Services by Patrick Schena in this Report 2014.

Table 1

Deal Concentration by Size (2013)

SWF	Target Company	Sub-Sector	US$ (Millions)
Qatar Investment Authority	Barwa's Real Estate Assets (Qatar)	Real estate - Mix	7,100
Qatar Investment Authority	Pengerang Integrated Complex Development (Malaysia)	Natural resources – Petrochemical	5,000
Mubadala Development Company	Bauxite & Aluminium infraestruture & Port (Guinea)	Natural resources & Construction	5,000
Khazanah Nasional Bhd Temasek Holdings	DUO Township (Singapore)	Real estate – Construction	3,194
GIC	Broadgate Office Complex (UK)	Real estate – Construction	2,720

Source: Fletcher SWF Transaction Database (2014).

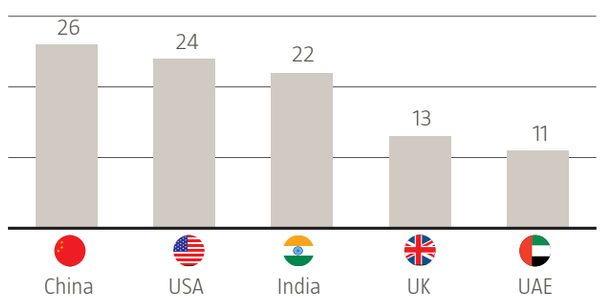
The average deal size of the top five deals in the last 5 years was approximately $3.7 billion; however, in 2013 this increased to about $4.6 billion. As many as 17 of the 25 top five annual deals since 2009 have been solo transactions. In line with this trend, three out of the top five deals of 2013 were also solo, including the largest announced, QIA's acquisition of Barwa's assets for $7.1 billion, completed through its real estate arm, Qatari Diar. Extending their tradition of active co-investment in large transactions, Temasek and Khazanah partnered to invest more than $3 billion in a township being developed in Singapore.

By fund based on number of deals completed, Temasek led the deal rankings in 2013, having completed the largest number of investments – approximately 40. It was followed by GIC with 27, Qatar Investment Authority with 20, Khazanah Nasional Bhd with 15, and China Investment Corporation with 12. Of the 67 deals completed by the two Singapore SWFs, investments in China accounted for as many as 20 deals, followed by 13 in India. By contrast, Qatar directed its attention to the Gulf-region, North America and South Asia, completing five investments in UAE and four in USA and India each. In line with their mandate, Khazanah made as many as six investments within Malaysia itself, and three investments each in Turkey and China.

Geographically, China was the target of the most deals (26) by SWFs in 2013, as followed closely by the USA and India (Chart 1). As noted, Temasek and GIC combined for 20 out of the 26 investments made in China – 14 by and 6 by GIC. Likewise, Singapore funds accounted for 12 of the 21 investments made in India. UAE made the other 9 investments in India. The US, somewhat expectedly, continued to attract the most diverse group of sovereign investors, with Singaporeans making 9 investments, followed by UAE (4), Norway (3), and one investment each from New Zealand, South Africa, Kuwait, Malaysia, and China.

Chart 1

Operations of SWFs by country in 2013



Source: Fletcher SWF Transaction Database (2014).

In Europe, Spain has been a destination for SWF investment over the last five years. While the number of investments has been limited, the deal size of each SWF investment has been relatively large on average. For example, Abu Dhabi's International Petroleum Investment Company invested twice in Spain-headquartered Compañía Española de Petróleos S. A. (CEPSA). The first investment, in 2009, involved purchase of a $4.37 billion stake in CEPSA, resulting in a 47% ownership position. In 2011, IPIC increased its holding in CEPSA by purchasing Total's stake for $5 billion. Also in 2011, now well documented, the QIA purchased a 6.1% stake in Iberdrola for about $2.8 billion. In return, Iberdrola agreed to establish a regional headquarter and a research & development unit in Qatar. In 2013, Temasek acquired a 5% stake in Spanish oil and gas giant Repsol for approximately $1.3 billion.

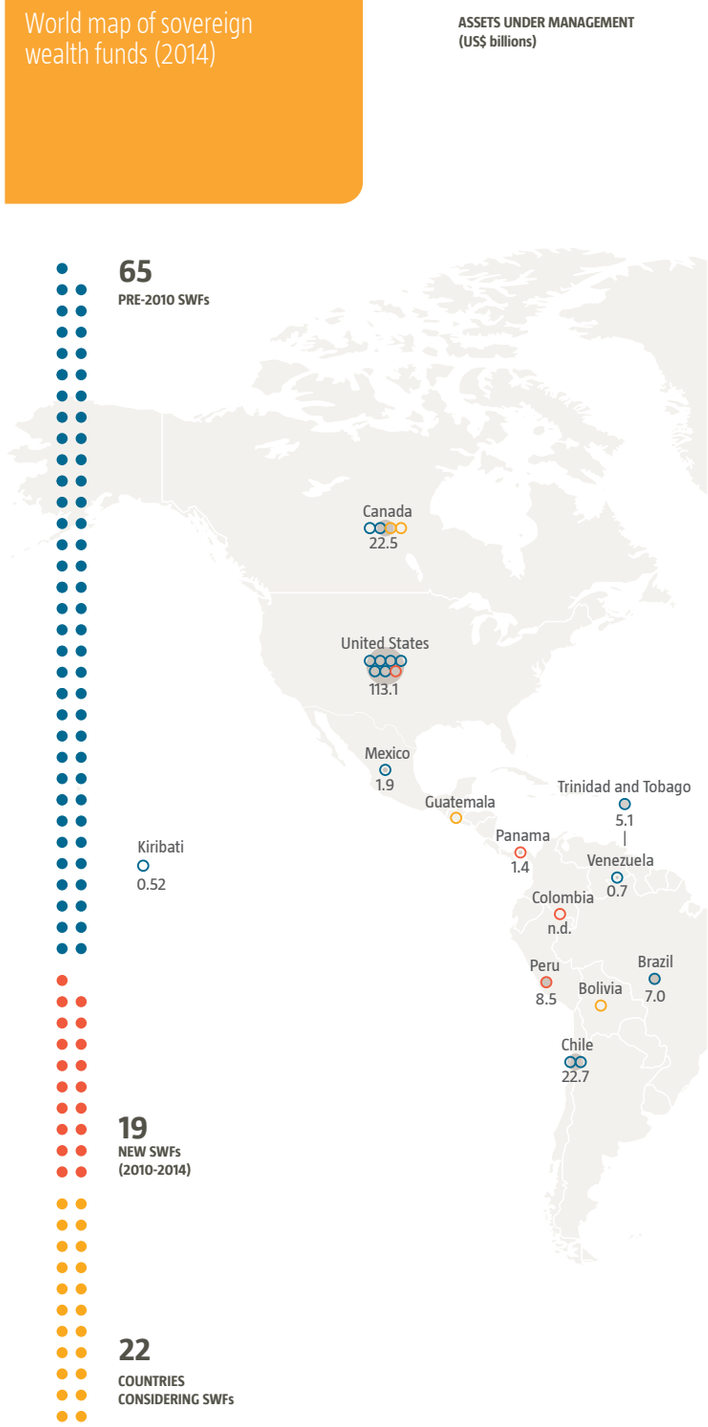
SWFs have likewise targeted Latin America for investment on a limited scale since 2009. There have been 17 identified deals in the region primarily across Brazil, Chile, Colombia, and Mexico. No clear trend emerges as a case for increased interest by SWFs in Latin America as the number of deals has varied from a few as one to as many as 7 (in 2010). In 2013, two interesting transactions of note are the team-up of Mubadala and Trafigura to invest US$ 966 million to acquire an iron-ore port – MMX Porto Sudeste - from Brazilian businessman Eike Batista and GIC's subscription to a capital increase in Aegea Saneamento e Participacoes SA, a unit of Grupo Equipav. Under the terms of the MMX Porto Sudeste deal, Trafigura will hold a 65% stake in MMX Porto Sudeste Ltda, which is currently under construction, while Mubadala will hold the remaining 35%. The GIC deal resulted in $135 million investment in the Brazilian water and sewage treatment company, which will be used to help the firm maintain its growth plans.

In 2013, of the 161 recorded deals, as many as 71 were co-investments, as SWFs partnered with other investors to form deal consortia. Over the last five years, almost 50% of the investments by count have been co-investments. As much as 65% of all partnerships are with other fund managers including private equity funds, insurance companies, and pension funds. On average, about 25% of all co-invested deals include a 'technical' partner. This trend continued in 2013, with 28% of the consortium deals having the involvement of a technical partner. SWFs will also partner directly with governments as local governments seek to attract SWF investment to their country. The previously noted Guinean government agreement with Mubadala to develop bauxite extraction and aluminum extraction capabilities is one such example. Likewise the Russian government, through Russia Direct Investment Fund, has been courting the China Investment Corporation and the Qatar Investment Authority to invest in Russian projects[4].

From a sector perspective, financial services, broadly defined, and real estate maintained their perennial lead as destination sectors for SWF investment. Out of the 49 investments in the finance sector, 11 investments were made in banks, 3 in market exchanges, 7 in insurance companies, and 22 investments were made in other investment structures, including funds and private partners such as private equity funds, REITS, etc. Such trends are much in line with SWFs investments observed over the last five years, when typically banks account for 25%, and investment funds account 40% of all investments received by finance sector. In real estate and construction we count approximately over 30 new deals; 10 out the 13 investments made in the natural resources sector were in oil, gas or coal. Lastly, investments made in the infrastructure were diversified utilities (6), power generation (2), ports (3), and transport (2).

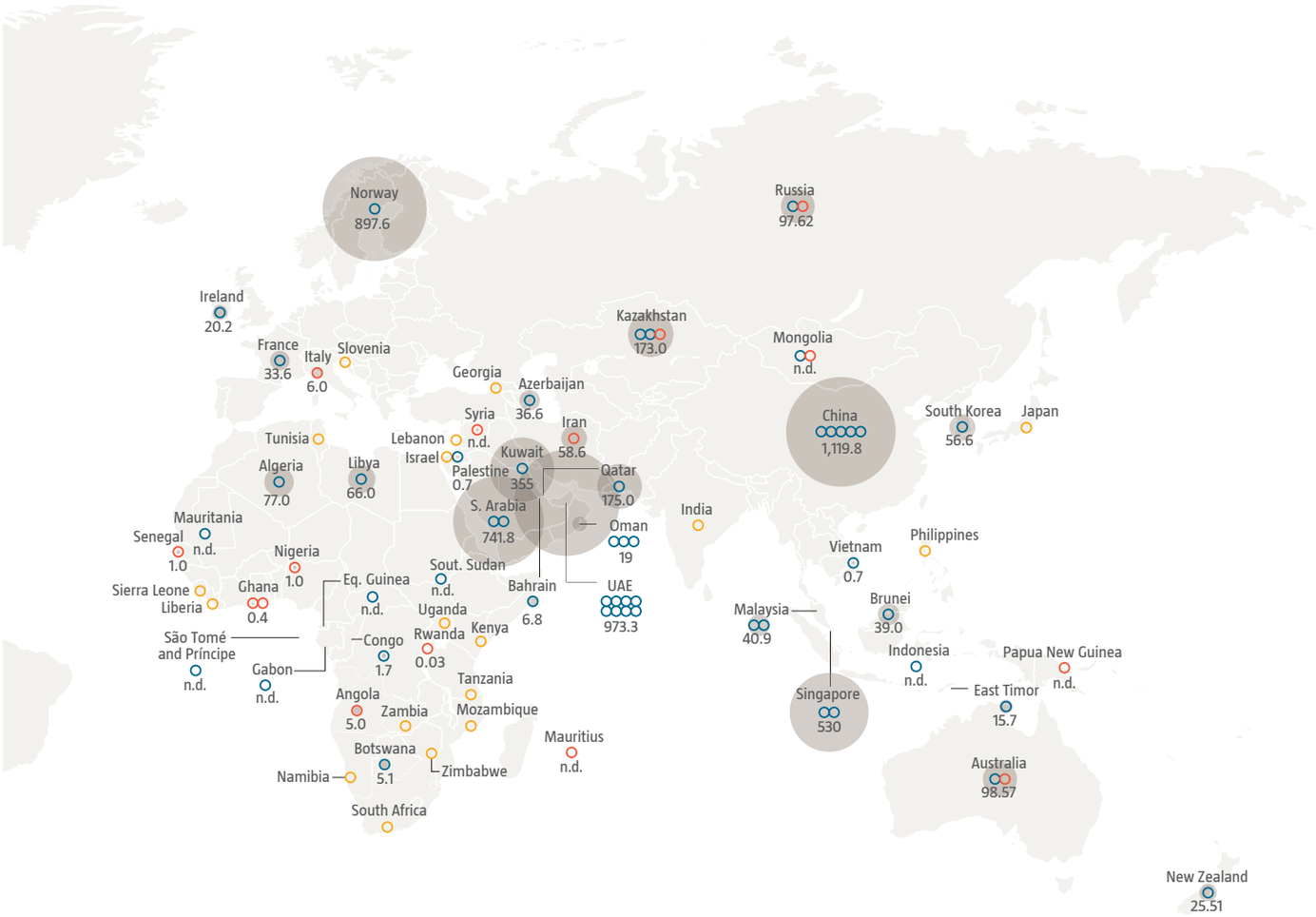
Infographic 1

World map of sovereign wealth funds (2014)



4 Check the chapter on Spain and Latin America within this 2014 SWF Report to see more examples of these agreements between governments and SWFs.

Currently, there are 84 active sovereign wealth funds, two more than our 2013 ESADEgeo SWF Report. 55 countries have established at least one SWF. Middle East, China, Southeast Asia and Norway are the four most active centers of SWFs. Assets under management sum up to 5.86 trillion dollars. SWFs have widely spread in recent years: in the last three years 7 new funds were established and 22 countries are considering establishing one. Debates over new SWFs are growing in East and South Africa and in Latin America. Thus, in 2014, there are 105 operating or projected-SWFs.



Source: ESADEgeo SWF Tracker (2014).

Global real estate focus

Elsewhere in this Report we return for a more focused look at SWF investment activity in financial services (Chapter 7). Here we will divert for a closer examination of SWF investment in real estate, which has emerged an important anchor asset class for many SWF portfolios. A closer focus on real estate in Spain involving SWFs is developed in Chapter 6.

Currently over 60% of SWFs allocate at least 5% of their portfolios to property either directly or indirectly [5]. Such patterns in asset allocation notwithstanding, it is primarily the largest SWFs who dominate led by investors in the GCC and Asia. New to this field is Norway's Government Pension Fund Global, whose mandate to deploy up to 5% of its $900 billion portfolio in global real estate, represents a sizeable overhang in global real estate markets. Such commitments reflect not only the scale of liquidity available among these investors, but also their capacity to invest over long horizons in less liquid, higher yielding assets, whose returns are less correlated with the balance of their portfolios. Market access occurs both through private real estate fund structures, as well as direct investments that include partnerships with both local and global real estate development companies. Geographically, North America and Europe, and in particular the UK, have attracted the most SWF real estate investment on the strength of asset quality. However, the pace of SWF flows into the real estate sectors of emerging economies has quickened in recent years.

Since 2006 SWF investment in global real estate markets has been dominated by 7 funds [6] that have participated in over 75% of the nearly 200 SWF transactions in the intervening period. Among these funds GIC, QIA, and Temasek have been the most active together participating in nearly 47% of the total transactions completed. NBIM, the manager of Norway's GPFG, initiated the build out of its mandate in 2011 and has dramatically expanded its scope since.

In 2013, 34 global real estate deals were completed by SWFs. The dominance of the core group - GIC, QIA, and Temasek - persisted with total deals constituting over 44% of the total. Also in 2013 GPFG established itself as an important investor in global real estate as it continued its aggressive investment program completing 5 deals or nearly 15% of the total.

As noted, SWFs have traditionally directed investment to developed markets in North America and Europe. In the US and UK alone since 2011, the portion of total SWF investment in real estate has expanded from 25% to over 40%. Interestingly, over the same period, SWFs have increased their commitment to properties in both South and Southeast Asia, where such deals have increased to over 40% of global totals. SWF geographic concentration by 2013 has therefore resulted in over 82% of all SWF investments in real estate undertaken across these four countries/regions.

Finally, with respect to market access, SWFs have exhibited flexibility by investing through both listed and unlisted structures, while the dominant SWF real estate investors also actively engage in direct transactions often in partnership with other SWFs or large institutions or with experienced property development firms. In 2013, fund or listed structures and direct commercial or office projects dominated equally, together constituting about 75% of transactions. Importantly, the volume of fund or limited partner participations appears also to have increased substantially over recent years. This is an interesting development, particularly in light of growing fee pressures on private structures and perhaps reflects a practical resolution in the trade-off between fees and capacity development among institutional investors.

As investors in this sector, SWFs certainly share the challenges of their institutional peers. Principle among these challenges today is a sizeable build up of global demand of between $350 billion and $500 billion by some estimates [7]. Similarly, the strategies they deploy are often designed to leverage potential competitive advantages to size and global reach. These include in-house capacity development to support more direct transactions, and particularly executed along side experienced local partners [8]. Several recent examples from the investment activities of SWFs in real estate will serve to illustrate.

We begin with GPFG, who has been among the most active real estate investors in the last 3 years and made its first investments in the US in 2013. For the year, GPFG returned a reported 11.8% on its real estate holdings as it continued its build out to a 5% allocation. This build-out of their continually growing portfolio will contribute directly to the above noted overhang in global real estate markets for the next several years. Karsten Kallevig, chief investment officer for real estate at NBIM has acknowledged that Norway's real estate investment program will evolve as a long-term initiative and will be challenged by the increasing growth of the overall assets of the GPFG [9].

As it builds its global portfolio, GPFG has focused on direct deals through which it could invest in scale. Its approach has to leverage the capacity and experience of local partners. In February 2013, NBIM announced a partnership with TIAA-CREF to create a joint

[5] "Sovereign Wealth Funds Investing in Real Estate", Real Estate Spotlight, November, 2013 (Preqin); https://www.preqin.com/docs/newsletters/RE/Preqin_Real_Estate_Spotlight_November_2013.pdf
[6] The SWFs include CIC, GIC, GPFG, Istithmar World, Mubadala, QIA, and Temasek.

[7] See The Real Estate Equation: Bridging the Divide; Global to Local, Macro to Micro, PwC, October, 2013; see http://www.pwc.com/en_GX/gx/deals/swf/publications/assets/the-real-estate-equation-bridging-the-divide-global-to-local.pdf
[8] Ibid.
[9] David M. Levitt, Christopher Spillane and Jonas Bergman, "TIAA-CREF Plans More Property Deals With Norwegian Fund", Bloomberg, Feb 12, 2013; see http://www.bloomberg.com/news/2013-02-11/norway-s-wealth-fund-makes-first-u-s-real-estate-purchase.html

venture through which it will co-invest in office properties in Boston, New York and Washington. TIAA-CREF owns 50.1% and will manage the joint venture, while NBIM holds the remaining 49.9%. The partnership is rooted in a mutual focus on a long-term investment horizon and an emphasis on large, high-quality assets in gateway cities [10].

Geographically, India, among the emerging economies of South and Southeast Asia, emerged as a destination for SWF real estate investment in 2013. A key representative SWF deal is the participation of GIC, Temasek, and Oman in a real estate private equity fund launched by HDFC Property Fund, a unit of India's largest mortgage lender. This co-investment team-up will provide the three sovereign investors access to Indian real estate through the market experience of HDFC. It builds on an earlier 2010 partnership between GIC, Temasek, ADIC, and HDFC Ventures, the venture arm of HDFC that involved the acquisition of a 10% stake in a 117 floor residential tower in Mumbai, the city's tallest development [11].

Finally, we cite the Qatar Investment Authority, who has long been an active investor in global real estate markets [12]. Its experience includes both direct and indirect market access and includes active partnership with experienced local investors/developers. In 2013, Qatar Holding exercised its interest in European real estate, particularly Italy, through a strategic partnership with Hines Italia to invest in Milan's Port Nuova [13]. The project has been billed as one of the most ambitious city center mixed-use developments in Europe with a reported market value in excess of €2 billion. The central building of Porta Nuova Garibaldi, which is leased to Unicredito, is Italy's tallest structure. In the transaction, Qatar Holding will further diversify its global real estate portfolio through increased participation in the Italian real estate market, acquiring a 40% with the remaining 60% owned by the current sponsors. This transaction builds on a QIA-Hines relationship, that includes Hines partnership with Qatari Diar, the QIA's real estate development entity, to design and construct a 370-room luxury hotel -the Conrad Washington, DC- and 70,000 square feet of large-format retail space at CityCenterDC in the US capital [14].

[10] See TIAA-CREF press release https://www.tiaa-cref.org/public/about/press/about_us/releases/articles/pressrelease443.html

[11] Maya Ando, "GIC, Temasek, Abu Dhabi and HDFC invest Mumbai's highest development", Asian Venture Capital Journal, 18 Aug 2010; http://www.avcj.com/avcj/news-analysis/1728403/gic-temasek-abu-dhabi-hdfc-invest-mumbais-development

[12] See Xavier Reig's "Sovereign wealth funds and real estate" in 2013 ESADEgeo SWF Report.

[13] See Hines press release at http://www.hines.com/press/releases/5-16-13.aspx

[14] See Hines press release at http://www.hines.com/press/releases/692014.aspx