



Ten Major Differences Between Real Estate Investing In China And Real Estate Investing In The United States



KIMBERLITE GROUP

By : Alan J. Pomerantz and Thomas M. Shoesmith

Commercial real estate is an approximately USD\$26 trillion (RMB 162 Trillion) global industry, The United States has over 25% of the global commercial real estate at almost USD\$7 Trillion. (RMB 43.7 Trillion). It has been estimated that in 2014 the United States will experience approximately USD\$6-14 Billion (RMB 37.4 -87.4 Billion) of Chinese investment in U.S. real estate, which is considerably more than the USD\$996 million (RMB 6.2 Trillion) invested for all of 2011 and 2012 combined.

Entities interested in investing in U.S. real estate are faced with a significant and complex array of state, local and federal regulations that can be challenging even to the most sophisticated and experienced investor. Real estate may be the most highly regulated and taxed asset class in the U.S. and is considerably more regulated and taxed than in China. And investors from China have an additional set of tax and regulatory complexities not faced by U.S. investors.

There is also a significant difference in the way deals are done in the U.S. and in China. Transactions fail more because of a difference in culture and expectations, than because of a difference in language.

The failure of a Chinese investor to understand these differences and address them correctly and at the proper time can often lead to a failed deal or an unfortunate one. Ten of the most important differences between investing in the U.S. and the PRC are:

1. Negotiating in the United States is different from negotiating in China.

In the United States, parties negotiate to make a deal. In China, they negotiate to build a relationship. In the U.S. very little is left to "later discussion" – all important points are expected to be negotiated and agreed to before the deal is made. In China, negotiations often continue after an agreement is reached. In the U.S., going back over points that have been agreed to or appear to have been agreed to is called "retrading," something U.S. businessmen try not to do, and consider it not dealing in good faith.

2. In the U.S., "business is business" – it's not personal... not so in China.

Don't underestimate how different business people will be in the U.S., and in ways you don't expect. In the United States, business is business, it is less political, personal and interpersonal than in China. American business people can often get right to the point, lay out their position, and try to cut through the "noise" to see if a deal can get done. They expect you to do the same. They often consider the process that is employed in China a waste of time. They are not being rude, they are just in a hurry to get the deal done and move on to the next one.

3. American businessmen don't usually socialize with their counter-parties.

Americans generally don't socialize or have dinners with their counter-parties or members of the other "team" while negotiating a deal. Many American businessmen think spending social time before the deal is made is not productive. We often think we have "better things to do," like trying to make the next deal. We like to show everyone how busy (and important) we are. Americans think the time for socializing is when the deal is signed. It's just the American way.

4. Transactions in the United States are fully documented.

In the United States, we expect the deal documents that are signed to be complete and reflect every aspect of the transaction. Accordingly, joint venture and partnership documents are often voluminous and complex. U.S. lawyers are trained to "think of everything." In the United States, there is no such thing as a standard deal.

5. Disputes in the U.S. are often solved by litigation, not negotiation.

America is a litigious society—that means people sue a lot, and it is not uncommon for a party to sue its partner, or a lender to sue its borrower. A U.S. partner will often take advantage of any lack of clarity in the documentation, something we call "wiggle room." Relationships in the U.S. can be more adversarial than relationships in China. Do not expect to find an agreeable partner or cooperative lender if things go wrong or not exactly as planned. And even when parties negotiate solutions to problems, it is often done against the background of what can be achieved in court. The U.S. has a well developed body of commercial law that often stretches back hundreds of years to when the U.S. was a British colony. And the courts will start with an examination of the documents.

6. Real Estate is heavily regulated.

There are 51 legal jurisdictions in the United States – 50 states and the federal system. Each state has different regulations that apply to real estate, and there are federal rules that pertain to the environment, health/safety, handicap access, and lending. A deal structure that works in one state may not work in another. The complexity of the U.S. legal system is considerably greater than in China. For example, each state has its own set of rules regarding protection of "mechanics," that is, the people or businesses who work on the real estate to maintain, repair or build it. Virtually every real estate asset is exposed to mechanics. In some states mechanics have the right to place a lien on real estate that will be superior in right and priority to the rights of the owner and the lender regardless of when the work was done. These rights do not exist in China.

7. Real estate is heavily taxed.

Real estate is the most heavily taxed asset in the U.S. and the tax code is complex - thousands of pages - and difficult to understand. While there exists a tax treaty between the U.S. and China, it generally does not apply to profits taxes imposed by states, cities and counties; nor to taxes imposed by state and local authorities on the acquisition, ownership, disposition, leasing, occupancy or financing of real estate assets. In addition, there are special U.S. tax rules for foreign investments in real estate (FIRPTA) that do not apply to U.S. investors. Therefore, a tax structure that is advantageous to a U.S. investor may be disadvantageous to a Chinese investor, and may lead to double taxation on profits realized by the Chinese investor. Tax planning before an investment is made is crucial.

8. The lender/borrower relationship in the U.S. is materially different from China.

The cooperative and supportive relationship that generally exists in China between lenders and borrowers does not exist in the United States. Unlike in China, United States lenders are generally prohibited from designating construction contractors, property managers or most operational guidelines. United States law has concepts that do not exist in China such as "lender liability" and "equitable subordination" which could cause a lender to be liable for acts of the borrower and lose its lien priority. Lenders in the United States do not act as partners with their borrowers.

9. The United States has a complex (and unexpected) bankruptcy code.

The United States has a bankruptcy code that generally favors creditors over lenders and owners, and tenants over landlords. The rights given to creditors and tenants do not exist in China. The U.S. bankruptcy code permits certain parties to terminate or "reject" contracts, reduce or wipe out equity positions, eliminate or modify a lender's lien, reduce the amount owed to a lender, and basically re-shape the capital structure of an enterprise. And certain agreements, even if made in good faith, will not be enforced if there is a bankruptcy proceeding. Proper understanding of the bankruptcy code and structuring of the investment is essential to provide the maximum protection to a partner or a lender.

10. Smart U.S. investors follow the "golden rule."

The golden rule in U.S. investing is: if you control the gold, you make the rules. The most protection an investor in, lender to, or owner of real estate can have is to control the cash of the project at every crucial phase. Achieving this goal is not done by the documents alone (see item 9 regarding the U.S. bankruptcy code), it is achieved by careful structuring the transaction. In the

United States, the party who controls the cash will generally be in the strongest position if there is a dispute, litigation or bankruptcy.

Conclusion

Because investing in the U.S. is far more complex than investing in China, it is crucial for Chinese investors to hire independent professionals who know all aspects of the industry to guide them through the process. Any real estate investment or venture will usually involve brokers, underwriters, leasing agents, asset and property managers, title agents, lawyers, bankers, accountants, lenders, appraisers, environmentalists, and engineers. Coordinating all of these professionals, and making certain they work together to achieve the best result, is a massive job that requires experienced professionals loyal only to you. Get them on your team at the start of the process to help you understand the system so together you can shape the acquisition/investment to achieve the result you want.

Mr. Pomerantz is the Vice Chairman of Kimberlite Advisors, LLC an advisory firm that works with U.S. and Chinese investors in real estate projects. Mr. Pomerantz has over forty years of experience in advising on U.S. real estate transactions. Mr. Shoesmith is a partner in the law firm Pillsbury Winthrop Shaw Pittman and is the head of its China practice and lived in China for many years.

Thomas M. Shoesmith | Partner, Pillsbury
2550 Hanover St. | Palo Alto, CA 94304-1115
p: +1.650.233.4553 | f: +1.650.233.4545
thomas.shoesmith@pillsburylaw.com | www.pillsburylaw.com

Alan J. Pomerantz | Vice Chairman, Kimberlite Advisors, LLC
188 Minna Street, Suite 27A | San Francisco, CA 94105-4051
p: +1.212.389.9417 | c: +1.917.593.4218 | f: +1.415.615.0732
apomerantz@kimberliteadvisors.com | www.kimberlitegroupllc.com

ATTORNEY ADVERTISING. Results depend on a number of factors unique to each matter. Prior results do not guarantee a similar outcome.

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171
www.pillsburylaw.com | © 2014 Pillsbury Winthrop Shaw Pittman LLP. All rights reserved.

Abu Dhabi • Austin • Houston • London • Los Angeles • Nashville Operations • New York
Northern Virginia • Palm Beach • Sacramento • San Diego • San Diego North County
San Francisco • Shanghai • Silicon Valley • Tokyo • Washington, DC

