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Richard Alter

Eddy Chao

Alter, Chao Link Asian Buyers To Western Opportunities

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Los Angeles—Two years ago, the Japanese owners of the Biltmore Hotel, Court and Office Tower in downtown Los Angeles decided to sell. They called Financial Capital Investment Co., a small investment advisor that had purchased the Pacific Center next door from Highridge Partners six months before. Financial Capital bought the Biltmore on behalf of Hong Kong-based Regal Hotels International. Meanwhile, Financial Capital began talks with the owners of another downtown L.A. hotel: the Inter-Continental Hotel. Early this year, it bought that, too, this time for a group of Taiwanese investors.

Financial Capital by no means wins every hotel or office deal in downtown L.A. But when it comes to representing Asian investors in L.A. or elsewhere in the United States, it has an enviable ability to form relationships.

"It is evident by the deals they've

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Financial Capital Clinches Deals With Focus on Relationships

Advisors Guide Asians To Profitable Hotel, Office Purchases

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done and the investors they represent overseas that they are spearheading the Asian investment effort in downtown L.A.," stated Bernard Siegel, senior vice president of Secured Capital Corp.'s hospitality division.

The company, headed by managing partners Richard Alter and Eddy Chao, invests Asian capital throughout the West Coast as well as in New York, and it is currently pursuing deals in Hawaii. Its clients now number about 100, and its total deals, which amounted to \$200 million per year in 1995 and \$250 million in 1996, leapt to about \$400 million this year, according to Alter. Reflecting Asian investors' current interests, hotel purchases make up two-thirds of its total asset and note buys, while office accounts for the remaining one-third. Office buildings run the gamut. They include the downtown L.A. trophy building 811 Wilshire Blvd. that it purchased from Prudential Insurance Co. of America but largely comprise Class B buildings, one source noted. Hotels tend to be upscale and have included, in addition to L.A.'s Biltmore and Inter-Continental, the Pleasanton Hilton outside San Francisco and the Whittier Hilton east of L.A. Those assets purchased two to three years ago have already doubled or tripled in value, Alter said.

As anyone who has attempted it has learned, forming relationships with Asian investors is not easy. Asian investors do not readily trust those they do not know, and they tend to prefer to send their own emissaries or set up their own companies to handle property purchases overseas. Although an increasing number of U.S. brokerage firms and investment advisors are rushing to set up operations focusing on foreign investment and seeking to establish operations in Asia, few have successfully broken through. Financial Capital's directors have worked long and hard to overcome that. Entirely focused on representing Asians of Chinese descent—essentially those in all Asian countries except Japan and Korea—they have spent years developing relationships, even when they did not immediately result in a purchase.

It helps that Chao is Taiwanese and developed many relationships growing up in Taiwan, and he combines that with a track record. "A lot of companies here hire Chinese, they hire Asians, and I think one of these days they're going to catch up," Chao observed. "At least at this time, my feeling is the people they hire either are not experienced enough, don't know how to deal with the people, are too young or just don't know the business that well. ... I have many years of working experience with investors."

Although Caucasian, Alter, a former

developer, formed his own relationships through syndicate work with Hong Kong and Japanese interests during the '80s. In fact, he cemented their confidence by warning investors not to buy during the '80s, when buildings were overpriced and values were only likely to drop.

Having met during that time, Chao and Alter began investing together when buying started to make sense again in the early '90s. One market player credited the team with being among the first companies, and the first U.S. company, to convince Asians of Chinese descent to consider the United States after Japanese investors suffered tremendous losses on their trophy purchases here.

"They were the first investment advisers to have ever established themselves as having a strong and successful capability in processing Southeast Asian capital both consistently and from a multitude of sources," agreed Financial Capital managing director Jeff Baize, who joined the company last year, having sold it 811 Wilshire Blvd. two years before while in charge of Prudential's general account portfolio in the Western United States.

Asserted Anthony Chien, advisor to the president & CEO of East-West Bank: "Taiwanese investors accumulated wealth in terms of cash in the last five years, in particular, and want to find a good area for investment: commercial real estate, particularly hotels, in the U.S., (mainly) in Southern California. In the last couple of years I think Eddy (Chao) has done a tremendous job (buying for them)."

FREQUENT FLIERS

Now, both travel to Asia frequently—Alter every two months and Chao every month—both to strengthen their relationships and to educate would-be investors on U.S. property. Frequent travel is expensive, but personal appearances are necessary. That is because, although Financial Capital has a full office in Taipei, an employee in Hong Kong and a partnership arrangement with an individual in Singapore, its employee base is tiny and it currently lacks principals overseas. Alter and Chao believe face-to-face meetings give them an advantage over U.S. brokerage houses that simply mail building prospectuses to strangers.

"(Investors) get the packages; they're sitting on their desks. Nobody substantially, certainly no senior person, goes from the brokerage houses to visit these people," Alter said. But with Chao a frequent visitor, he noted, his is the first name that comes to mind when the investor becomes interested in a site.

Alter and Chao refuse to allow work with clients to extend to such side entertainment trips as visits to U.S. casinos or shopping centers. Yet Mark Sullivan, director of the Asia/Pacific Real Estate Group for Price Waterhouse, who has assisted Financial Capital with due diligence or tax issues on a number of acquisitions, revealed a more personal attempt to develop relationships: "Richard spends enormous amounts of time with his clients: social activities, when the children are having a birthday, family functions. It's Taiwanese family money vs. Japanese institutional. So he's recognizing the difference in structure."

FINANCIAL CAPITAL: MAJOR TRANSACTIONS

- Hotel Inter-Continental, Los Angeles: 433-room hotel; purchased for group of Taiwanese investors in January 1997
- Biltmore Hotel, Court and Office Tower, Los Angeles: 673-room hotel, 350,000-SF office tower; bought in 1996, then flipped to Hong Kong hotel owner Regal Hotels International
- Pacific Center, Los Angeles: 430,000-SF office tower; purchased for Taiwanese and Chinese investors in 1995
- 811 Wilshire Blvd., Los Angeles: 316,000-SF office tower; purchased for Taiwanese investors in 1995
- Pleasanton Hilton, Pleasanton, Calif.: 294-room hotel; purchased for a group of Taiwanese, Chinese and other Southeast Asian investors in 1996

charge of the Pacific Rim group for law firm Cox, Castle & Nicholson L.L.P., makes Financial Capital's business viable despite a disadvantage in size against the Kennedy Wilson Internationals of the world. "I don't believe they have the infrastructure, but I don't think they need it," he said, describing Financial Capital as a boutique. "They've developed such strong relationships that I don't think they need an enormous marketing side. They can go direct to the sources they have."

But forming relationships is not enough. The differences between business in Asia and the United States can daunt even a strong partnership. American companies must understand the differences in their Asian clients' perceptions well enough to translate for them, and Asian advisors may understand their clients but must also be able to interpret the U.S. markets.

"There are a lot of groups out there attempting to do it the Asian way," warned Hotel Partners Inc. executive vice president & principal Russell Urban. "They're going to have a tougher time of it." He added: "I think (Chao and Alter) have done a very good job of taking the Asian money and culture and funneling it through what I consider to be a reasonably Americanized company. It's difficult for a lot of Asian groups to do business in the U.S., and I think Richard Alter has done a good job of doing that."

Asian investors use very different factors in determining the value of real estate. They tend to like landmark office and are willing to buy trophy buildings with 70 percent occupancy, banking on long-term gain. They also lean toward hotels because hotel operation does not vary much from East to West, so they understand it. They tend to look, however, at price per room or per square foot,

or to compare current price to original cost, rather than considering capitalization rates or cash flow.

Alter pointed out that large hotel chains naturally look at cap rates. "That makes them on certain properties non-competitive on a price standpoint." So Financial Capital seeks the hotels that the big companies will not buy direct but that nonetheless have upside potential. "Obviously, (Asian investors) like a \$100 million building they can buy for \$30 million," Alter added. "We will buy on that basis. Not every U.S. institution can do that."

Financial Capital spends a significant amount of time educating its clients and prospective clients. Through seminars and newsletters, the company teaches them about how the U.S. market works and supplies them with needed information. That means explaining cap rates, but it also means providing market information, which Asian investors often do not realize they need.

Although willing to help its clients learn, however, Financial Capital operates under some strict rules. Asian investors it takes on as clients must be ready to buy. "When we get new people, we tell them, 'If you're thinking about something for us, that's not good enough.' They already have to be well-disposed to invest in the U.S.," Alter explained. "We'll definitely say, 'What is your entry strategy? Why are you doing this? If we can't delineate precisely in 50 words or less why you are doing this, we don't want to do transactions.' ... We certainly are in a risk business, but we are not in the speculation business."

That does not mean the company will abandon a potential relationship that stands on shaky investment ground. Instead, it puts those on a back burner, maintaining the relationship and providing some additional education so that when the investor is at last ready the two can work together. "I started to work with (some) investors from China back in the early '90s—the late '80s and early '90s," said Chao. "For so many years, I never did any transaction with them. And I knew it was not going to happen because I knew they were not sophisticated yet. The need for them to invest in U.S. real estate was not that strong yet; the motivation was not there. But ... it's getting closer and closer



Financial Capital has built its business by carefully developing relationships. That led it to buy the Fairfield Inn. "If we never hired (PM Realty) as property manager, it never would have happened," said managing partner Richard Alter.

because Hong Kong (has gone) back, and if anything happens in a couple of years, you'll see a lot of money start coming in." He added: "You will not do any business with any investors until they speak the same language as you. If they don't have the same type of mindset, you've got to spend some time. Even if they're ready, willing and able to buy, you've got to spend a few hours, until they start to really fully understand the way the process works here and the way to look at an investment here."

Investors ready to move forward are often pooled into funds of six or so with similar interests. Although Financial Capital does not always retain some ownership of the property itself, it frequently does, either putting up 10 percent or so of the funds itself or gaining an ownership share as partial payment for use of its investment expertise. "For the most part, we decline to do any project where the investors say, 'We don't want you to be an owner,'" Alter said. "We say, 'We want the project to be successful. We as 25 percent owner want this major project to be successful.' We like to work with investors who need us. Not everybody needs us."

Financial Capital works so closely with its clients that some of those relationships have expanded into other business ventures. When one Chinese partner needed machinery made only in Michigan, Chao and Alter arranged the purchase and invested their own capital in the deal. Financial Capital has even done some commodity trading at client request. Such ventures would seem quite a deviation from the real estate business, but the investment advisors view it as an unsought opportunity.

"The only reason that we would feel comfortable doing that is that it happens to be one of our existing investors and we're doing a service for him, so we know each other, and he has all the sites in China and the contacts to get it done," Alter said. He also affirmed that they do say "no" when they have no capability to do what is being asked.

Like many investors today, Financial Capital seeks possible sales not yet presented to the market, and it has achieved a number of purchases because of previous relationships. It bought Pacific Center in downtown L.A. from Highridge Partners in January 1995,

closing the deal the day after Highridge closed on the Pacific Telesis portfolio in which it was included. A year later, that deal gave rise to the purchase of The Biltmore Hotel and office building. "Because we had the building (taking up the rest of the block), the owner of the Biltmore called us," related Alter. "He said, 'We own the rest of the block. Would you guys be interested in doing this?'" Another relationship clinched the deal. Richfield Hospitality Services managed another hotel for Financial Capital. Since it is affiliated with hotel investor Regal, Financial Capital inquired as to its interest in buying the property. The deal was signed last summer.

A management relationship also gained Financial Capital the Fairfield Inn in Orange County. With PM Realty Group managing 811 Wilshire Blvd., Alter and Chao were meeting with then-CEO Michael Lutton one day. By chance, they learned a related entity, Jupiter Realty Group, had a hotel for sale. "(Lutton) got on the phone and called up Jupiter and said, 'Would you sell to Richard and Eddy?' and they said, 'Sure,'" Alter recalled. "If we never hired (PM Realty) as property manager, it never would have happened."

MARKET VALUE PLUS \$1

But Financial Capital cannot always depend on existing relationships. When it does enter a bidding war, it does so aggressively. A common tactic is to offer what Alter and Chao describe as "market value plus \$1." Although the company does not literally offer just \$1, it does determine a percentage above market value that would still be reasonable yet ensure it can secure the asset. For instance, in one situation last year, the seller returned once it had made a proposal to find out if it were willing to go higher to beat out another, unspecified bid in the \$10 million range. Concerned they would not win the asset, Chao and Alter added \$200,000 to that number. "And the guy shook our hand and said, 'Congratulations, you just bought yourself a project,'" Alter related. "We might have been able to get by with \$25,000 or \$50,000 and be successful. But our approach is: We want to own that; we've got the money in the bank; we spent all this time; for \$200,000 we got the deal. That project



"You will not do any business with any investors until they speak the same language as you. ... You've got to spend some time (teaching them about the U.S. market)," observed managing partner Eddy Chao.



Managing director Jeff Baize is developing one of Financial Capital's newest ventures, a fund for high-net-worth Asian investors and U.S. pension funds. Baize joined the company last year, having previously sold it an L.A. office building.

today is worth \$15 million or \$16 million. We made the right decision." He added: "The difficulty, of course, is figuring out exactly what that number is. If he had said \$1 million, we would have walked from the deal."

Chao added: "If the profit you're going to earn in the future can justify the price you're going to overpay, I think that's OK."

The number they choose is based on an order of magnitude compared to the amount of return they expect to gain from the property—and, of course, they will only raise their bid in this way if the site has no downside risk, Chao noted.

Despite such dealmaking tactics, Financial Capital is not perceived as spendthrift. "They've got reasonably endless resources and when you look at several projects we put before them, they have not been the high bidder (because) they reached a plateau and were not willing to go higher," Urban said. He added: "I have found Financial Capital to be very prudent buyers, driven by the bottom line." He further complimented the company for being economically driven rather than ego driven when it comes to choosing properties, selecting them for their value rather than simply pursuing trophy assets.

That economic view affects the size of properties Financial Capital pursues, too. Chao and Alter prefer 10-story buildings to one-story structures, since they believe clients should see the buildings they might buy, and both travel and due diligence are more cost effective for a larger purchase. The economics of travel have led them to do the majority of their deals in California as well, with only a few in New York, as California is closer to Asia. That makes flying out for half a day to see a building more viable. Hawaii would also make sense for that reason.

Alter and Chao also have a reputation for being very trustworthy buyers. "In a transaction, (Alter) is very straightforward and pretty well does what he said he would," observed Jack Mahoney, president of Highridge Partners affiliate Summit Commercial. Added Sullivan: "The hallmark with Richard is whatever he says he's going to do, he does. ... His word is very important to him."

"A very typical thing happened on Inter-Continental," Alter related gleefully. "While we were in the process of closing, a number of people called up the seller and said, 'Eddy and Richard are not going to close, drop them and go with us.'" Finally, one last bidder called the sellers, the Long-Term Credit Bank of Japan and Tobishima Development Co., with its line of persuasion. "And the seller hesitates and says, 'You know, they recorded and closed that last week,'" Alter said, laughing.

Financial Capital first approached the Inter-Continental's owners two years ago, suspecting the hotel had been under financial duress since it had been built and that the Japanese lenders might like to sell. Although it was too soon, the interest was duly noted, and the owners opened talks at the beginning of 1996. The two teams—the Japanese owners represented by Eastdil Realty Co.—came to an agreement during the summer and reached a final sale in January. The property went for a purported \$40 million; developer Tobishima is reported to have originally put in \$46 million in equity, while the Long-Term Credit Bank of Japan is

said to have placed \$79 million in debt.

An unexpected investor in that deal came in the form of Lehman Brothers, which expressed interest in the transaction during an unrelated discussion with Financial Capital. Lehman had invested in a note with the investment advisor previously. Although Financial Capital has not pursued coinvestment with other Wall Street firms and would have closed that deal regardless of Lehman's participation, it did welcome the new source of funds and is pursuing more business with the Wall Street player.

EXPANDED INVESTORS

"Part of our goal is to further expand our Asian investors by having Wall Street investors ... and I think it provides additional credibility when we go out and do the next deal with Asian investors and work with Wall Street investors, too," Alter explained. "It's not our primary focus, but it's certainly a secondary focus."

Currently, Baize is building a fund for high-net-worth Asian investors and more traditional U.S. institutional investors such as state pension funds. Expected to reach \$200 million, it will target quality hotel and office properties within the Western United States and Hawaii. Plans are already under way for subsequent funds, Baize said.

Financial Capital will enter some other new areas this year. It is scheduled to close on a California residential development fund this fall, creating a highly leveraged joint venture type of fund through which to invest. Uncharacteristically, it would have a very short-term return—around 18 months. Possibilities also exist for investment in Japan. The firm should begin doing that by the last quarter of '97 even while it continues to invest in the United States. Further down the road, when the cycles shift again in America, it may become a seller here, although Asians prefer to be long-term investors, holding assets for 10 years or so. Also further ahead, at least five years from now, China or Mexico may prove additional investment options.

The focus on Chinese-descended Asians, however, will not change. "Our perception is Asia is inherently unstable—forever," Alter explained. The theory goes that as one country stabilizes another experiences some risk. The Hong Kong Chinese sought to invest money outside the then-colony for several years before the Chinese reclaimed the islands. Aging presidents create another reason for unrest, as do new presidents seeking to modify constitutions. Indonesia is a case in point. "It's one of the top countries in the world in population," Alter said. "We're seeing more and more Indonesian Chinese people move, and in a year we think we'll move from Indonesia to the next country where they have the same problem."

As a result of such shifts in unrest, Financial Capital, which largely works with Hong Kong, Chinese, Singaporean, Indonesian and Taiwanese investors now, will begin to alter its investor mix. Singapore promises upcoming potential, as does mainland China, but Hong Kong individuals did much of their external investing before the reclamation. Other likely sources of capital include Vietnam, the Philippines, possibly Thailand—and then the cycle begins again. "These are the countries that you see unstable all the time," Chao noted. "You never see them peaceful for more than a year." ■