Executive Summary

New Neighbors: 2018 Update

Chinese Investment in the United States by Congressional District

A Report by the National Committee on U.S.-China Relations and Rhodium Group *April 2018*

Over the past decade Chinese outbound investment has become an important new component of US-China economic relations. Annual Chinese direct investment in the US grew from far less than $1 billion before 2008 to more than $46 billion in 2016. While re-kindling some old anxieties about national security risks from foreign ownership, this growth raised hopes and expectations in many local communities that China could follow the example of Japan and become a major driver of local investment bringing jobs, tax revenue, innovation and other benefits.

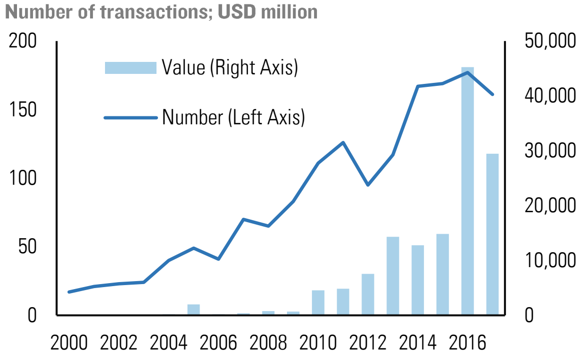
Developments in 2017 have dampened these hopes. Chinese FDI in the US dropped by more than one third last year, the first major correction in a decade. In terms of newly announced transactions the decline was even sharper: the value of announced deals in 2017 fell more than 90% from 2016. The impact from this decline in FDI activity was also felt on the local level. Planned greenfield projects were delayed, fewer jobs were added to Chinese payrolls compared to previous years and some Chinese companies even began seeking buyers for their US assets.

The decline in Chinese investment last year was mostly triggered by policy shifts in both China and the US, not commercial dynamics. These new policy attitudes are unlikely to reverse fully anytime soon, suggesting that lower levels of investment will persist in the near term.

These new realities will require local America to adjust how it views Chinese investment. The potential is still huge, but a changing US-China relationship requires a different approach. Smart officials and investors will still get deals done but only if they understand the new patterns and risk factors.

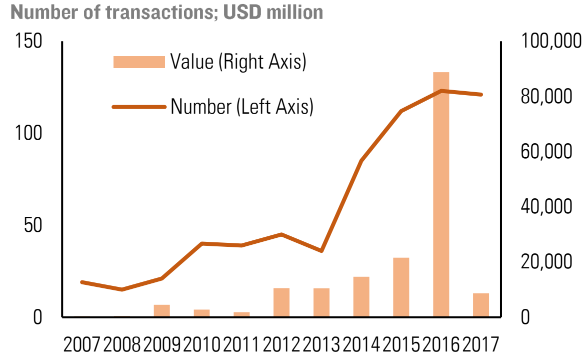
Since 2015 our "New Neighbors" report series has analyzed the operations of Chinese-owned companies in the United States and the local impacts of these firms' investments. This update summarizes the major changes in Chinese outbound FDI patterns in 2017 and describes how Chinese investment footprints have changed during the year by region, state and congressional district.[1]

Figure 1: Completed Chinese FDI Transactions in the US
Number of transactions; USD million



Source: Rhodium Group. See Data Appendix in full report for more details.

Figure 2: Newly Announced Chinese FDI Transactions in the US
Number of transactions; USD million



Source: Rhodium Group. See Data Appendix in full report for more details.

[1] "Operations" and "establishments" are used interchangeably in this report to describe each geographically distinct operation of a business within the United States. "Chinese-owned" refers to firms in which Mainland Chinese investors have a significant and long-term interest (at least 10% of equity or voting rights). See the Data Appendix in the full report for more details.

Chinese FDI in the US dropped markedly

After a record 2016 the value of consummated Chinese direct investment transactions in the United States dropped to $29 billion in 2017 (Figure 1). This represents a year-over-year drop of more than a third (35%). The number of completed transactions dropped by 9%.

The 2017 number was propped up significantly by deals carried over from 2016. In terms of new activity the drop of Chinese investment was even sharper – the value of newly announced Chinese acquisitions in the US in 2017 dropped by 90% compared to 2016 (Figure 2).

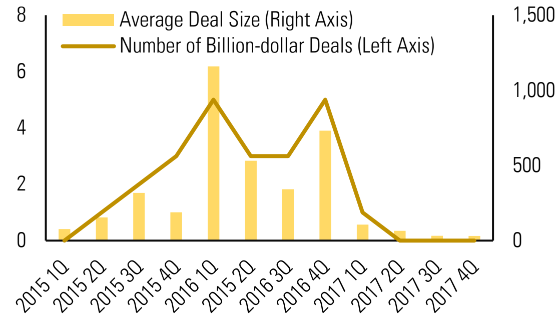
Policy shifts were responsible for this decline

In late 2016 Chinese regulators launched an informal crackdown on "irrational" outbound investment to counter large-scale capital outflows that were melting down China's reserves. In August 2017 these informal policies were codified in a new OFDI regime based on lists of six types of encouraged investments, five types of restricted investments and five types of prohibited investments.

Chinese regulators also began to scrutinize large private conglomerates' outbound investment activities in May 2017 as part of a broader effort to clean up risks and reduce leverage in China's financial sector. Many of these investors – including entertainment empire Wanda and conglomerate HNA Group – have been aggressive overseas dealmakers in recent years and were responsible for a significant share of total Chinese investment in the United States.

The second factor explaining the 2017 decline in both completed and announced transactions was greater US regulatory pushback. An unprecedented number of Chinese deals were delayed or abandoned in 2017 as parties failed to obtain approval from the Committee on Foreign Investment in the United States (CFIUS), which screens foreign acquisitions for potential national security risks. Growing CFIUS deal risk was driven by two factors: first, the slow progress of the US government transition between administrations left many leadership positions unfilled for the better part of 2017, causing delays and a cycle of re-submissions. Second, and more importantly, CFIUS has broadened its approach to reviewing Chinese deals, taking into consideration a wider array of criteria when assessing security risks. For example, in 2017 CFIUS indicated concerns about state-sponsored M&A activity to obtain certain technologies and data protection for US citizens.

Figure 3: Average Announced Deal Size in the US
Number of transactions; USD million



Source: Rhodium Group. See Data Appendix in full report for more details.

Acquisitions continued to dominate but the average deal size shrunk

Mergers and acquisitions (M&A) continued to account for most of Chinese investment activity during the year with 97 transactions worth $28.6 billion (97% of total investment). The biggest transactions were HNA's acquisitions of CIT's aircraft leasing unit, a stake in Hilton Hotels and 245 Park Avenue in New York; Tencent's stake in SNAP; and China Life's purchase of a 48-property US commercial real estate portfolio.

The number of M&A deals declined slightly (97 compared to 108 in 2016) but the average transaction size fell from $410 million in 2016 to $295 million in 2017. If it were not for two large transactions carried over from 2016 (HNA's acquisitions of CIT's aircraft leasing unit and its stake in Hilton hotels) the average transaction value would have been just $120 million. The number of large billion-dollar deals fell from 16 in 2016 to just one in 2017 (Figure 3).

Another important development in 2017 was that many Chinese investors shifted from full-blown takeovers to minority stakes (less than 50%). HNA's 25% stake in Hilton Worldwide Holdings and Tencent's 12% stake in SNAP are the two most prominent examples. Venture capital and other non-FDI minority stakes also held up better in 2017 than large buyouts.

Greenfield investments were more stable but still impacted by policy changes

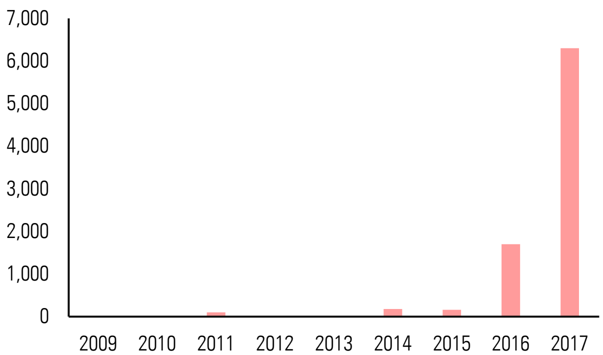
Greenfield FDI remained largely stable in 2017 and slightly increased its relative share of total Chinese FDI in the US due to the decline in M&A activity.

The most important greenfield projects under construction or announced in 2017 were Volvo's additional $520 million investment in its South Carolina plant, Triangle Tyre's plant in North Carolina, Wanhua's chemical plant in Louisiana, Wanli's tire plant in South Carolina and Ruyi's textile plant in Arkansas.

Notably, a handful of greenfield projects ran into problems due to Chinese capital controls and the crackdown on private firms. Several real estate developers as well as manufacturing companies announced they would downscale or abandon projects as they were unable to fulfill their financing commitments. Examples included Tranlin Paper's $2 billion plant in Virginia, Faraday Future's electric vehicle plant in Nevada and Greenland's real estate project in the San Francisco Bay Area. The total value of canceled greenfield projects exceeded $6 billion (Figure 4).

Figure 4: Value of Canceled Chinese Greenfield Projects in the US*

USD million



Source: Rhodium Group. *Includes the value of all cancelled Chinese greenfield projects in the US with over $50 million of announced investment.

Divestitures picked up as several Chinese heavyweights moved to deleverage

For the past decade, Chinese downsizing has largely been limited to firms that were already distressed at the time of acquisition (e.g. Motorola Mobility in 2014) or cases in which regulators ordered divestitures (e.g. Ironshore in 2016). This changed in 2017 as several Chinese players were forced to put their US assets up for sale to reduce debt loads stemming in part from their hasty overseas expansions. Most of these cases involved commercial real estate holdings and related assets.

Divestitures in 2017 included LeEco selling its Santa Clara headquarters, Greenland looking to sell its Oyster Point development in San Francisco and Wanda looking to sell its One Beverly Hills development. By early 2018 more firms had put up their assets for sale: After less than a year HNA was in talks to sell 245 Park Avenue and is reportedly looking for a buyer for assets that it acquired as part of the Hilton Hotels stake (Park Hotels and Resorts, Hilton Grand Vacations). Insurance firm Anbang was taken over by Chinese regulators and is now reportedly looking for a buyer of several US property and hotel assets as well.

Some industries have weathered the storm better than others

In 2017 the ranking of top industries largely reflected big deals carried over from 2016 including HNA's acquisitions of CIT's aircraft leasing unit ($10.4 billion) and a 25% stake in Hilton Worldwide Holdings ($6.5 billion) as well as Beijing Shanhai Capital's acquisition of Analogix Semiconductor ($500 million) (Table 1).

Table 1: Top Industries for Chinese FDI in the US, 2017

Industry	USD billion
Real Estate and Hospitality	11 bn
Transport and Infrastructure	10 bn
Health and Biotech	2.5 bn
ICT	2.5 bn
Financial and Business Services	1.3 bn
Entertainment	0.5 bn
Automotive	0.5 bn
Electronics	0.2 bn

Source: Rhodium Group. See Data Appendix in full report for more details.

In terms of new investment activity the momentum clearly turned against the sectors that Beijing put in its crosshairs as part of the regulatory tightening started in late 2016: entertainment, real estate and hospitality.

Changes in US regulators' attitudes also impacted industry patterns. CFIUS prevented almost $10 billion of Chinese acquisitions in 2017 including Canyon Bridge Capital's proposed takeover of Lattice Semiconductor and Zhongwang's acquisition of Aleris. This partially reflects long-standing scrutiny of Chinese investments in high-tech sectors relevant to defense (semiconductors) but is also a result of new concerns such as investments in "emerging critical technologies" and companies that possess large troves of US citizens' personal data – illustrated by earlier Chinese transactions (Ironshore, Global Eagle Entertainment) and in early 2018 by Ant Financial's failed MoneyGram takeover.

Industries that were relatively resilient included health and biotech (Dendreon Pharmaceuticals, SciClone Pharmaceuticals and Obagi Medical Products) and ICT (SNAP, Analogix Semiconductor and Flipagram).

Transport, logistics and infrastructure investment also jumped up due to HNA's acquisition of CIT's aircraft leasing business and CIC and China Life's investment in Interpark. This is reflective of a global trend of Chinese investors riding the "Belt and Road" wave to continue making large overseas investments despite Chinese regulatory tightening.

The biggest recipients of Chinese capital in 2017 were New York, California and Massachusetts

The 161 completed Chinese FDI transactions we record for 2017 include more than 270 individual operations. Adding all Hilton Hotels locations would push this number to over 3,000.

California was the leading destination for Chinese FDI, receiving investments in varied sectors including ICT (SNAP in CA-33 and CA-12), health and biotech (Obagi Medical Products in CA-45), agriculture and food (Clougherty Packing in CA-34) and entertainment (SeaWorld in CA-52) (Table 2).

New York came in second, receiving big investments in real estate (HNA's 245 Park Avenue acquisition) and transport and infrastructure (CIT's aircraft leasing unit).

Massachusetts also became to a top destination for Chinese FDI mostly due to two large acquisitions in financial and business services (OM Asset Management and International Data Group).

Table 2: Top Districts Attracting Chinese FDI in 2017

District	USD billion	Major Investments
NY-12	2.3 bn	CIT Aircraft Leasing Unit, 245 Park Ave.
CA-33	1.2 bn	SNAP, Flipagram
CA-14	0.7 bn	SciClone Pharmaceuticals
MA-5	0.7 bn	International Data Group
SC-2	0.7 bn	Ritedose
NY-10	0.7 bn	SNAP, Dendreon Pharmaceuticals
CA-17	0.6 bn	Analogix Semiconductor
CA-12	0.6 bn	SNAP, International Data Group
MA-7	0.6 bn	OM Asset Management
IL-2	0.5 bn	181 W. Madison St.

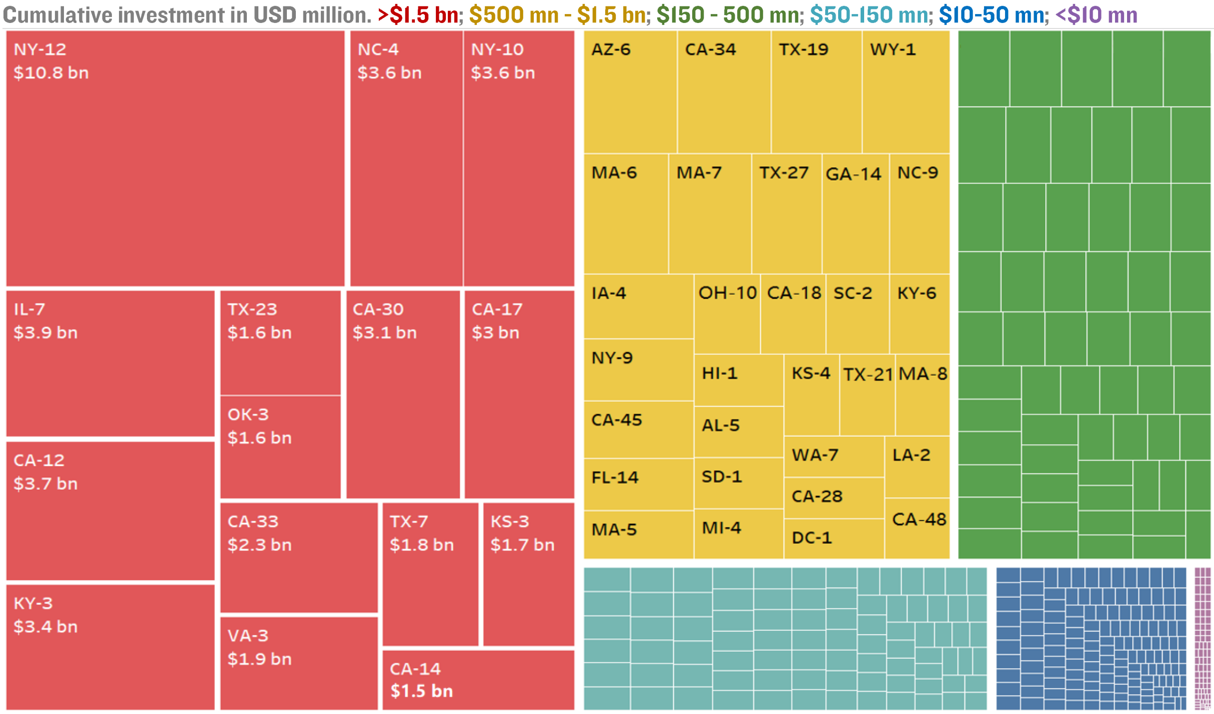
Source: Rhodium Group. See Data Appendix in full report for more details.

South Carolina also received several large investments in health and biotech (Ritedose) and automotive (the completion of the first phase of Volvo's auto plant), and Washington got a boost from Dendreon Pharmaceuticals, which has a medical and operations unit located in Seattle.

At the end of 2017 the total number of Chinese-owned operations in the US reached 3,400 (over 6,000 with all

Figure 5: Chinese FDI in the US by Congressional District, 2000-2017

Cumulative investment in USD million. >$1.5 bn; $500 mn - $1.5 bn; $150 - 500 mn; $50-150 mn; $10-50 mn; <$10 mn



Source: Rhodium Group. See Appendix in the full report for complete data for all districts.

Hilton properties). 425 of 435 congressional districts (98%) now host Chinese-owned establishments.

Most districts (236 or 54%) have received less than $50 million in Chinese investment since 2000. 146 districts (34%) have received more substantial investment in the $50-500 million range, while 43 districts (10%) have landed more than $500 million.

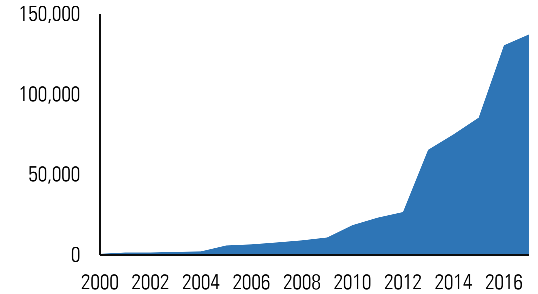
The ranking of top districts for cumulative Chinese FDI remained similar to 2016: NY-12 leads thanks to large real estate investments. IL-07 (Motorola and InterContinental and Fairmont hotels) and NC-04 (IBM's PC division) follow (Figure 5).

The investment slowdown impacted Chinese firms' employment footprint

Chinese companies added about 7,400 US employees to their payrolls in 2017 – the lowest increase in five years. The total number of Americans directly employed by Chinese-owned companies in the US reached 139,600 (Figure 6). This employment count only includes full-time direct jobs at US entities that are at least 50% owned by a Chinese parent company.

Figure 6: Employment at Chinese-owned Companies in the US

Number of full-time direct jobs



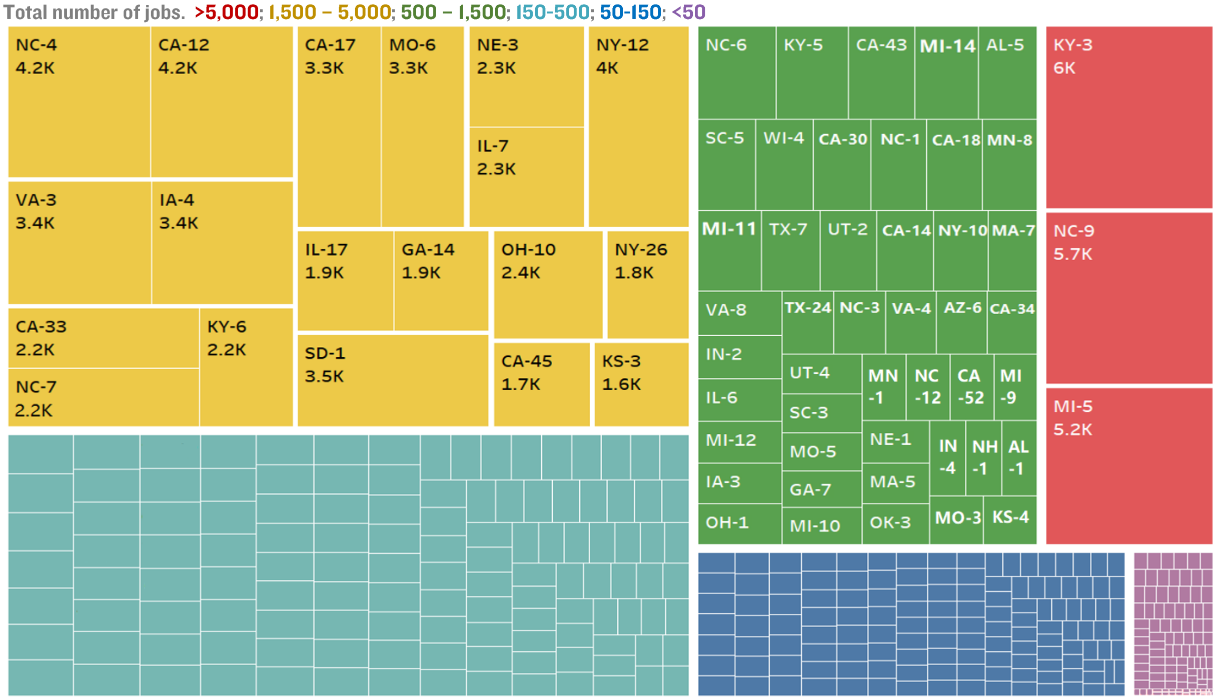
Source: Rhodium Group. See Data Appendix in full report for more details.

US companies with Chinese minority ownership (between 10% to 50%) employed an additional 10,000 people before 2017. Last year this number went up by tens of thousands largely because of HNA's 25% stake in Hilton Worldwide Holdings (which employs 163,000 full-time and part-time workers worldwide).

These figures do not include indirect jobs supported during project construction or at suppliers. We estimate Chinese investors in the US indirectly support tens of thousands of additional jobs.

Figure 7: Number of Employees at Chinese-Owned US Operations, 2017

Total number of jobs. >5,000; 1,500 – 5,000; 500 – 1,500; 150-500; 50-150; <50



Source: Rhodium Group. See Appendix in the full report for complete data for all districts.

As with previous years, most of the 7,400 jobs added to Chinese payrolls in 2017 (86%) came through acquisitions. Compared to previous years there were proportionally more "medium-sized" acquisitions of firms with 50-200 employees.

The number of new jobs created through greenfield projects and expansions remained small compared to the number of acquired employees in 2017. The most important greenfield projects for job creation were the first phase of Volvo's South Carolina plant, Giti's South Carolina tire plant and Wonderful Group's tile plant in Tennessee.

In addition to manufacturing, greenfield investments in technology sectors such as electric vehicles (NIO in CA-12, BYD in CA-23), autonomous vehicles (TuSimple in CA-52, Baidu's self-driving car lab in CA-17), artificial intelligence (Alibaba HQ in WA-9) and mobile payments (Tencent in CA-18) continued to grow quickly, adding more than 1,000 jobs in 2017. However, greenfield job creation was lower than it might have been due to abandoned large-scale greenfield projects including Tranlin Paper's plant in Virginia and Faraday future's Nevada plant.

The top districts in terms of total employment supported by Chinese companies are KY-3 (GE Appliances unit), NC-9 (Smithfield Foods), MI-5 (Nexteer Automotive) and NC-4 (Lenovo) (Figure 7).

Considering newly created jobs through greenfield projects only, we get a different picture. The congressional districts with the most newly created greenfield jobs are OH-10 (Fuyao Glass), SC-5 (Keer Group, Giti's tire plant, and Haier Group) and TX-27 (Tianjin Pipe Corporation).

Outlook: Priorities in a New Era

The *commercial* rationale for further Chinese investment in the US economy remains strong. There is natural complementarity in terms of comparative advantage, Chinese firms already have export market shares in the US they need to defend, opportunities are shrinking at home relative to in the US and the US market remains an attractive place for foreign investors seeking diversification. However, political risk for Chinese firms is on the rise in both China and the US, weighing against these commercial forces. These policy headwinds are more likely to worsen than dissipate in the near term.

China's tightening of outbound investment rules was mainly responsible for the 2017 drop in Chinese FDI to the US. The new outbound investment regime implemented in the fall of 2017 has cemented China's backslide to an environment where regulators may freely interfere with transactions to address macroeconomic anxieties as well as deal-specific concerns.

Going forward, Beijing faces a dilemma as policy impulses pull in contradictory directions. On the one hand, Beijing has staked its reputation on being a global financial and economic player. This means in part letting firms – especially private ones – make their own profit-oriented decisions about global investing. On the other hand, Beijing's insistence on political command and control of the domestic economy has brought a large and growing cost in terms of financial inefficiencies, and hence risks. Uncertainty around how these competing forces will play out is clouding the picture of future outbound investment. If Beijing pursues its ambitious global agenda, it will be hog-tied in terms of holding off pressures on the domestic financial system; if Beijing focuses on controlling its domestic system, it will be unable to fulfill its ambitious global agenda.

Stiffer American screening intervention was partially responsible for lower Chinese investment levels in 2017 as well. Continuing a trend started in the last year of the Obama administration, the Trump administration expanded CFIUS scrutiny over Chinese acquisitions of US high-tech companies and broadened the scope of concerns to include issues such as protecting US citizens' personal data. There is bipartisan consensus in Congress to expand and strengthen the legal mandate behind CFIUS, for example to include certain types of non-FDI investment such as venture capital financing.

Washington has moved past *whether* it should alter the rules and environment for Chinese and other FDI in the US to *how* it should do so. Chinese and other foreign investors are already finding that the US landscape has changed, even before the formal rules have been rewritten. This dynamic leaves businesses confused – both at home and abroad. Having erased the old assumptions, the federal government now has the burden of redrawing new ones, and it needs to do so quickly. This process must include Congress and the executive branch as well as the holistic array of departments represented in the CFIUS process.

As lawmakers make these important decisions, they must balance better defensive measures against the opportunities foreign investment brings to their states and districts. They should remember that competition to attract global investors and the taxes and paychecks they bring is intense, and that politicization of deals and political gamesmanship may deter Chinese and other international investors.

Finally, many local governments and US businesses that based their expectations on 2015-2016 investment patterns will need to revisit their strategies and deal with new realities. The data presented in this report is a good starting point:

First, certain sectors have come under increased Chinese regulatory scrutiny, making outbound investment difficult. In August 2017 China officially implemented a new outbound FDI regime based on lists of encouraged, restricted and prohibited investments. Specifically, real estate, entertainment, sports clubs, movie theaters and financial investment platforms are now restricted. These had been some of the most attractive sectors for Chinese investment in the United States, and our data already show a large drop-off in Chinese activity in these areas.

Second, last year's developments also underscore how quickly tables can turn against investors that Beijing perceives as irrational or overly aggressive. Going forward, real economy firms with low debt and clear overseas expansion rationales pursuing small- and medium-sized deals are the best candidates for receiving support for investments in the US. But even with proper due diligence, politics in China can heavily impact Chinese firms' standing and financial positions, so proper risk management remains important.

Third, it is prudent to prepare for a more confrontational US-China relationship, especially in high-tech. Greater scrutiny of Chinese acquisitions derailed several big tech deals in the US last year, and CFIUS will be more active going forward. A revamped CFIUS could not only deter high-tech acquisitions but also reduce Chinese greenfield FDI in R&D centers and other innovative activities in certain areas if current legislative proposals to prohibit or restrict the transfer of technology and know-how back to China prevail.

Fourth, and perhaps counterintuitively, US states and businesses should also look for *opportunities* arising from this less harmonious relationship. If frictions result in additional barriers to trade, greenfield investment that can no longer easily flow to high-tech should naturally find its way into conventional manufacturing sectors as Chinese producers seek to localize production "inside the tariff wall" to defend their US market shares. This is what happened in the case of US-Japan trade frictions and subsequent investment growth in the 1980s and 1990s.

Finally, local interests have an important role to play in the evolving debate about foreign investment. Today all eyes are on the epic clash of powers playing out on the geopolitical stage and the concomitant struggle for influence over the policy framework for defending the national interest on view in Washington. Given the importance of changes in China's economic development model and national security concerns which are handled by central agencies, it is natural that Washington should be in the driver's seat. Stepped-up policymaking is evident in London, Berlin, Paris, Canberra, Ottawa and many other capitals as well.

But at the same time it is essential to remember that in our democracies the costs and benefits accruing to individuals and localities must be carefully evaluated, even when national security is at issue. If new regulations disrupt or take rights away from private firms and business people, provisions to maintain due process will be necessary. This is not just on principle, but because the faith and confidence of private enterprise in our democratic, liberal economic model is the wellspring of our security.

About this Report

About the National Committee on U.S.-China Relations

The National Committee on United States-China Relations (NCUSCR) is a private, nonpartisan, American non-profit organization that promotes understanding and cooperation between the United States and Greater China in the belief that sound and productive Sino-American relations serve vital American and world interests. Since its founding in 1966, the Committee has created opportunities for informed discussion and reasoned debate about issues of common interest and concern to the United States, Mainland China, Hong Kong and Taiwan. NCUSCR currently organizes programs for private and public sector participants on politics and security, governance and civil society, economics and finance, education, and transnational issues such as energy and environment. It carries out its mission via conferences and forums, public education programs, professional exchanges and collaborative projects.

About Rhodium Group

Rhodium Group (RHG) is an economic research firm that combines policy experience, quantitative economic tools and on-the-ground research to analyze disruptive global trends. It supports the investment management, strategic planning and policy needs of clients in the financial, corporate, non-profit, and government sectors. RHG has offices in New York, California and Hong Kong, and associates in Washington, New Delhi and Singapore. The firm's cross-border investment practice analyzes the rise of China and other emerging markets as trans-national investors. RHG senior staff publish frequently on the growth and impact of Chinese outbound FDI in the United States, and maintain the China Investment Monitor, a database tracking Chinese investment in the United States.

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