January 2010

Latin American Quarterly

Market Perspective

Executive Summary

- Latin America is expected to post solid GDP growth in 2010, fueled by consumer demand from a growing middle class. Property markets have begun to thaw, although a full recovery is not expected until late in the year.
- Capital markets in Latin America rallied at the end of 2009, and the good performance is expected to continue. Strong performance by homebuilders and retailers boosted Latin American stock markets. Corporate debt issuance made a comeback after drying up earlier in the year.
- Retail sales posted large increases in some countries, especially among companies focused on lower-income consumers. Demand for retail space is rising in some countries, although in Mexico shopping centers continue to have trouble attracting smaller tenants.
- Demand for office space in Latin America is mixed. Occupancy levels have risen in Brazil and Chile, while dropping in Mexico. Leasing activity is growing for industrial properties in Mexico.
- Homebuilders targeting the low-income segment are building units at a rapid clip to take advantage of the demand generated by low-cost mortgage programs. Several homebuilders in Brazil have issued equity and debt to finance new expansion plans.

Overview

Progress in the economic landscape of Latin America that began in 2009 should continue in 2010, albeit to varying degrees across different countries. Government stimulus measures and strong consumer demand created by a steady rise in employment served to boost growth to pre-recession levels in Brazil and Chile. Growth has stagnated in other countries, including Mexico, due in part to weak demand for exports from trading partners.

Property markets are improving, although signs of a full recovery are not expected to surface until the second half of this year. The demand for consumer goods manufactured in the region is a boon for the industrial market. Leasing activity for industrial properties in Mexico has picked up slightly as some industrial companies are searching for space.

Retail property managers in Mexico are struggling with volatile vacancy rates, leading to a greater focus on more anchor-reliant formats. In Mexico and Brazil, demand for low-income housing remains strong, helped by the presence of government initiatives and a growing middle class.

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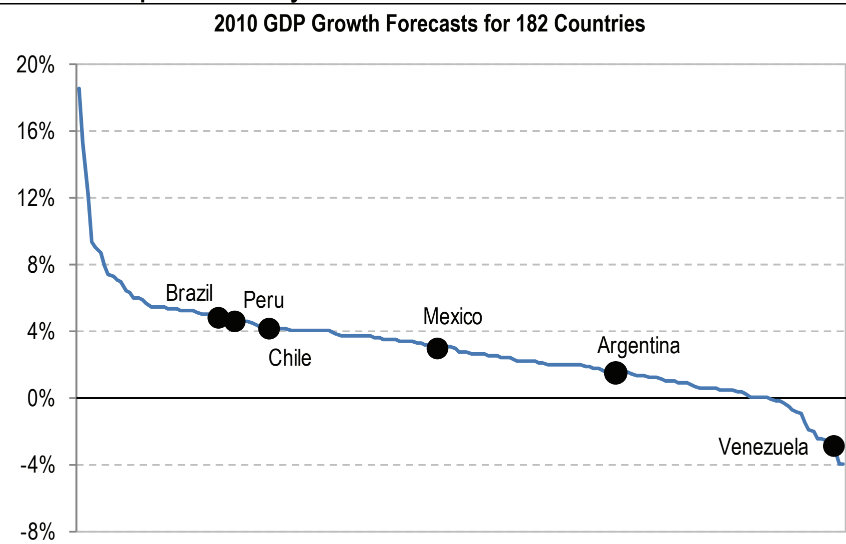
Regional Economies

Third-quarter GDP numbers for Latin American countries were weak year-over-year, but showed improvement over the prior quarter, pointing to a recovery across the region. According to the Economist Intelligence Unit (EIU), Mexico (-7.1%), Venezuela (-2.9%) and Chile (-1.0%) will post GDP contractions in 2009, Brazil will be flat and Colombia (0.2%), Peru (0.3%) and Argentina (0.6%) will grow slightly. The EIU forecasts growth in all countries except Venezuela in 2010. Brazil (4.8%) was on top, followed by Peru (4.6%), Chile (4.2%), Mexico (3%), Colombia (2.5%) and Argentina (1.9%). The EIU's 3.2% forecast for Latin America ranked second among regions of the world, trailing only Asia. As a recovery takes root, a desire for political reform is sweeping through the region, although only time will tell if it produces any long-term changes to the political landscape.

The weak labor market in the U.S. had a harsh effect on Mexico's export levels. However, there was a pick-up in the third quarter, when GDP posted a 2.9% increase from 2Q09. The increase in productivity levels was reflected in Mexico's unemployment rate, which declined to 5.3% at the end of November, down from 6.4% in September.

2010 Growth Expectations Vary Across Latin American Economies



International Monetary Fund, Economist Intelligence Unit

In Brazil, strong fundamentals and government stimulus measures allowed the country to emerge relatively unscathed compared to other markets. Nonetheless, the government announced a new stimulus package worth US$4.5 billion in December. The package extends the repeal of the industrial tax on capital goods and technological products through June 2010 and also eliminates the import tax for oil refining and petrochemical products. Brazil's national development bank (BNDES) will also provide US$45.5 billion of credit to non-financial companies in an effort to boost Brazil's industrial sector. Brazil's unemployment rate remains on a steady decline, falling to 7.4% in November, its lowest level since December 2008. Brazil gained nearly 250,000 jobs in November, a record high. Accordingly, the nation's consumer confidence index rose to pre-recession levels during the fourth quarter, reflecting greater optimism among Brazilians.

Chile posted a 1% yearly expansion in industrial production in November, according to government agency INE, the first increase in 13 months. Chile's monthly economic activity index rose 3.1% in November, the largest monthly increase recorded since June 2008, according to INE. The unemployment rate fell to 8.8% in November, down from its yearly high of 11.1% in June, according to INE. Consumer confidence levels in Chile posted double-digit increases in the third quarter, reflecting an improved outlook for 2010.

Capital Markets

Public companies in the region raised US$13.3 billion of equity during the fourth quarter, more than twice the US$6.5 billion raised in 3Q09. Brazilian bank Santander raised nearly US$8 billion via an IPO, the largest-ever offering in Brazil and the largest in the world for the year. Local real estate companies, most notably Brazilian homebuilders, were also active in the capital markets. Broad equity market indexes posted growth in 2009 in Argentina (103%), Peru (101%), Brazil (70.4%), Venezuela (57%), Colombia (52.2%), Chile (47%) and Mexico (38.1%).

Amid signs of recuperation in global economic activity, and improved local employment and credit conditions, most central banks in the region kept interest rates constant. Colombia was the only country in the region to cut its key interest rate in the fourth quarter, by 50 bps, to 3.5%, as the economy stagnated. Several countries in the region posted record low inflation levels in 2009. According to INE, Chile posted annual inflation of -1.4%, its lowest level in 74 years. In Mexico, inflation closed out the year at 3.6%, which fell within the central bank's target range, according to government institute Inegi. In Brazil, government institute IBGE reported that 2009 inflation decreased to 4.3%, from 5.9% in 2008. However, economists are concerned that rising global commodity prices and government spending will result in a steep increase in inflation. Central banks in the region are expected to begin to tighten monetary policy as early as the first quarter of 2010.

In December, Moody's raised Peru's rating to "Baa3," putting the country at an investment-grade level. The move opens up the country to a larger pool of foreign investors. Moody's cited the country's "increased resilience to shocks and reduced credit risks associated with financial dollarization and the currency composition of government debt," as well as the ability of the Peruvian government to successfully implement counter-cyclical macroeconomic policies during the crisis.

Property Markets

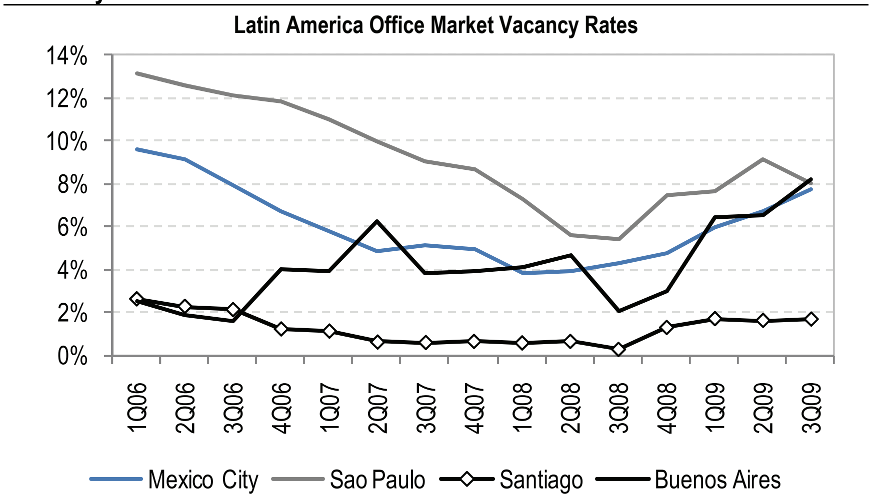
Industrial: The industrial sector in Latin America was the first to suffer during the recession, and now it is the first to show signs of recovery. Consumers have become more confident about their household finances, generating new demand and leading companies to resume halted expansion plans.

A manufacturing index in Mexico developed by the IMEF, Mexico's Institute of Finance Executives, rose in October to its highest level since April 2008. The employment component of the index posted positive readings through the end of 2009, suggesting that job losses in the manufacturing sector will moderate. After a year of declining sales, Mexico's vehicle production rose in November and December, according to Mexico's auto industry association AMIA. During the fourth quarter, leasing activity in Mexico's industrial market began to reflect signs of recovery. Anecdotally, tenants are signing leases for new space for warehouses and industrial facilities, and build-to-suit projects that had been stalled during the recession are being completed. Rent levels, however, remain depressed, as inventory increased over the past two years.

Brazil posted a 5.1% year-over-year expansion in industrial production in November, according to IBGE, its first increase in a year. Brazil's annual auto production declined 1% from 2008, although auto sales posted an 11.4% increase and reached a record level of 3.4 million units, according to national automakers association Anfavea. Brazil's domestic demand has remained strong despite the recession as a result of the Brazilian government's repeal of the industrial tax on new vehicle purchases. Some new industrial investments were announced during the quarter. In November, Coca-Cola announced it will invest US$5.8 billion in Brazil over the next five years, a 75% increase from the amount invested in the previous five-year period. The decision was due in part to Brazil's hosting of both the 2014 FIFA World Cup in soccer and 2016 Summer Olympic Games. In December, Renault announced plans to invest US$568 million over the next three years in Brazil in order to increase its market share there.

Office: The diversity of Latin American office markets was readily apparent in the second half of 2009. In markets where the downturn was more severe, leasing activity stalled and fundamentals weakened. In markets in which a recovery was underway, vacancy levels and rental rates remained stable or posted slight improvements.

Vacancy Levels in Latin American Office Markets are Mixed



CBRE

The average class-A vacancy rate in Mexico City rose 100 bps during the third quarter, to 7.7%, according to CBRE, as companies delayed expansion plans and scaled back operations. Some 8% of total available space is up for sub-lease, leading to increased competition for tenants and lower rental rates. The average class-A office lease rate fell to US$24.91 per square meter in 3Q09 from US$25.52/sqm in the previous quarter. Vacancies are expected to continue rising unless there is a strong recovery in the Mexican economy that prompts rising demand for space in 2010.

In Sao Paulo, Brazil's top office market, the 3Q09 average class-A vacancy rate dropped to 8%, from 9.2% in the previous quarter, according to CBRE. The rate had been just 5.4% in 3Q08, so the downward movement could indicate that companies are resuming normal operations as the economy begins to grow again. Average rental rates have been stable, hovering in the mid- to high- US$40/sqm range.

Vacancies in the office market in Santiago, Chile, increased by less than 100 bps, according to CBRE. While absorption is weak, most major projects that were scheduled to come online in 2009 were postponed until 2010. Average rental rates were relatively unchanged. Office rental rates are declining while vacancies are growing in Buenos Aires, Argentina. CBRE reported that the class-A vacancy rate in 3Q09 rose 170 bps to 8.2%, as companies downsized while new supply hit the market. As a result, there is expected to be a lull in new office projects.

Retail: Stabilizing unemployment rates and rising consumer and business confidence boosted the retail sector in Latin America during 4Q09. Sales growth has prompted larger and more-established retailers to plan expansions in 2010. Across the region, stalled retail projects have begun to resume, and retail company stocks are outperforming other sectors, especially in Brazil. Brazilian shopping center companies Iguatemi (161.5%), Multiplan (159.6%) and BR Malls (124.0%) all outperformed Brazil's Bovespa index, which rose 70.4% in 2009, according to Bloomberg.

Consumer confidence and retail sales are picking up in Mexico. Yet retail properties are struggling as some smaller tenants vacate space or demand shorter lease terms amid uncertainty about sales. The situation has improved from a year ago, however. In particular, larger discount retailers continue to benefit from the recovery as more money-conscious consumers emerge from the crisis in search of a bargain. As a result, the focus on a more anchor-reliant retail format remains dominant among new developments. Wal-Mart Mexico posted record annual sales in 2009 of US$21 billion, a 10.4% increase from 2008. Wal-Mart Mexico opened 275 new stores during the year, bringing its total to 1,472. Retailers Coppel, Soriana, Best Buy, Oxxo and Costco have also announced plans to expand in Mexico in 2010.

In October, consumer confidence among Brazilians rose to its highest level since May 2008, according to the Getulio Vargas Foundation, or FGV. That, coupled with the jobs recovery, explains October's 8.4% increase in retail sales year-over-year and 1.4% from September, according to IBGE. Retailers in Brazil reported record holiday sales volume in December, although final numbers are not yet available. The positive retail sales were reflected in expansion plans among retailers. Brazilian mall operator BR Malls paid local firm JHSF US$114 million for the Metro Santa Cruz mall in Sao Paulo.

Chile's retail sector is benefitting from strong employment growth and rising consumer and business confidence. Year-over-year retail sales in Chile increased 9.3% in November, according to Chile's National Chamber of Commerce (CNC), prompting a boom in retail construction. Chilean retailer Cencosud restarted work on the US$700 million Costanera Center in the national capital of Santiago after 10 months of delay. Local developers are also looking beyond Chile for opportunities. Chilean mall developer Parque Arauco announced plans in December to spend US$140 million building a new mall in Bogata, Colombia.

Residential: Homebuilders' stock prices have made big gains this year, and companies that focus on the low-income housing sector have performed the strongest. The shares of Mexican homebuilders Geo (115.3%), Ara (65.9%) and Urbi (47.7%) outperformed the Mexican IPC index, which rose 38.1%, according to Bloomberg. In Brazil, where a government housing program was introduced earlier this year, major homebuilders posted triple-digit gains, including Rossi (293.3%), MRV (285.3%), PDG Realty (204.4%) and Cyrela (150.3%), compared to 70.4% for Brazil's Bovespa Index.

Local homebuilders in Brazil are taking advantage of the government program Minha Casa Minha Vida, which was designed to provide low-cost mortgages to stimulate demand in the low-income housing sector. Brazilian homebuilders PDG (US$535 million) and Rossi (US$469 million) raised equity in October that will be used to finance growth in the low-income housing market. Brazilian developer Cyrela raised US$617 million in October through a stock offering, while homebuilders Tecnisa and Rodobens issued debt in December. Rodobens is developing about 90% of its housing projects in conjunction with the Minha Casa Minha Vida program.

Infonavit, the Mexican government's largest mortgage originator, originated nearly 450,000 new mortgages in 2009, falling short of its 500,000 goal. Infonavit's 2010 goal is to write between 475,000 and 525,000 new mortgages, which represents US$8 billion or more in credit. Infonavit estimates 60% of its 2010 product will serve the lower-income demographic. Both Infonavit and Fovissste, the government's second-largest mortgage originator, issued MBS during the fourth quarter. The two agencies raised just shy of US$2 billion combined in the capital markets in 2009.

Closing Thoughts

The shockwaves of the global financial crisis impacted Latin America on several levels in 2009. Real economic activity stalled during the first half of the year, leading to rising unemployment and economic deterioration. The financial markets were the first to hit bottom but also the first to anticipate the recovery that started to materialize toward the end of the year. The strength of the recovery has varied across countries in the region, and the recovery will continue to be uneven going forward. The critical factor will be local economic drivers – such as consumption growth and the availability of credit, which have driven the expansion in homeownership in Latin America. Home sales among higher-income consumers will probably slow down while demand for affordable homes should remain strong.

Commercial real estate values will continue to be depressed over the near term, as rental rates in all sectors are weak due to lack of demand. However, there are bright spots in certain corners of the market, with some industrial, retail and office activity picking up for the first time in more than a year.

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