

## **MEXICO'S INDUSTRIAL REAL ESTATE MARKET IN RECOVERY**

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Although experts predicted that the Mexican Industrial real estate market would not recover until 2011, the market began to show signs of recovery during the second half of 2010. Since then, it has remained stable, despite the downturn in the U.S. economy, following the global financial crisis of late 2008.

This early recovery was possible, in part, due to Mexico's economic stability, reflected in a deficit of just 2.5 percent of GDP, and a foreign debt equivalent of 20 percent of GDP (in comparison to Brazil at 60 percent). At the end of 2010, Mexico had \$114 billion in international reserves and an economic growth rate of 4.4 percent.

The macroeconomic soundness of Mexico coincided with an improvement in the U.S. automotive market, which triggered new manufacturing initiatives from multinational companies, such as Ford Motor, Co., Nissan, Chrysler, Volkswagen, General Motors and Pirelli, and more recently Mazda. For 2010, foreign direct investment (FDI) inflows into Mexico totaled \$17.7 billion, an amount 55 percent higher than 2009. Consequently, manufacturing exports increased 29.5 percent to \$246 billion. A major portion of that was Mexico's auto exports, which rose 53 percent, to \$65 billion, mainly to the U.S. market. Any increase in the automotive market sales is directly reflected in higher occupancy rates in industrial buildings, as big assembly operations require Tier 1 and Tier 2 suppliers to be located in close proximity. That's why the automotive sector has more presence in Mexican industrial parks.

Trying to take advantage of the increasing FDI inflows during the past year, Mexican industrial developers made a good effort to match their available buildings, which remained empty during the crises, with the occupancy demand of suppliers along the production chain of new manufacturing projects. While FDI growth has not been sufficient to recover the pre-crisis occupancy levels, this extra effort helped developers increase the occupancy rate of industrial buildings, on average, by 86 percent since 2010.

In March 2010, industrial development companies, such as the former AMB Property Mexico (now Prologis), as well as Promecap, a newly created fund from Prudential Real Estate Investors (PREI), placed about 5.8 billion pesos (\$460 million USD) in

equity-linked structured notes known as CKDs on the Mexican Stock Exchange. The investment is for the development of new industrial and logistics real estate projects in the country.

Despite the highlighting of drug cartel violence by the international media, Mexico's popularity among foreign investors is still strong. Official figures recently published by the Mexican government indicate that the majority of the population remains unaffected by the drug-related violence, because most of the homicides are among gang members. Although the problem of insecurity is considered a risk factor, investors take into account other aspects related to the country's competitive advantages. These advantages include the availability of a skilled labor force, the proximity to the U.S. market, the free-trade agreements signed with 43 countries and the administrative capacity to manage these plants with local talent.

According to US consultant firm Alix Partners, Mexico ranked number one as the lowest cost manufacturing outsourcing country for the U.S. market in 2010, considering basic wages, inventory and transportation costs. Mexico's ranking was possible because the country's manufacturing wage levels are closing the gap with those in China, from 240 percent higher in 2002, to only 14 percent higher in 2010. Another reason is increasing transportation costs, a factor that gives Mexico an edge versus China's distant geographic location, particularly when it comes to bulky goods. That is why Mexican exports to the U.S. Market have gained ground against the Chinese.

A preliminary conclusion is that the market outlook for 2011-2013 is positive, although still low, due in part to the strong dependence that Mexico has on the U.S. market. More than 50 percent of Mexico's FDI inflows in the manufacturing sector come from U.S. Companies. It is well known that if the U.S. government is not able to resolve the deficit problem, the economy will suffer a greater slowdown and this situation would definitely impact the Mexican economy.

According to Deloitte, Mexico remains among the top 10 countries for investors in 2011. Growing investor confidence in Mexico's macroeconomic stability is expected to play a major role in FDI recovery, which some experts predict will reach up to \$25 billion by the end of 2011, and much as \$28 billion in 2012.

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