Executive Summary

Macro Economic Themes

• Latin American economies were boosted by the strong US economy in the first quarter, which led to improvement in consumer confidence and the appreciation of currencies.

• Policymakers are closely monitoring growth risks due to renewed uncertainty surrounding the sovereign debt crisis in Europe and reduced growth outlook for China, which is a major destination for commodities from Brazil and Chile.

• Growth in Mexico in recent quarters has been stronger than anticipated, and is expected to gain momentum as the US recovery strengthens. As usual, manufacturing is expected to drive growth this year, although the retail sector is contributing an increasing share of growth as the domestic economy recovers and consumers gain confidence.

• Full-year GDP growth slowed in Brazil in 2011 amid depressed global demand for exports and a weaker domestic economy. Brazilian authorities reacted to slower growth by introducing stimulus packages designed to boost the economy, especially the industrial sector.

Implications and Outlook for Commercial Real Estate

• Real estate fundamentals in the region are improving, keyed by strong demand for space and the lack of high-quality properties in many markets. Vacancy rates are generally decreasing in most property types, which has a positive impact on rents and property values.

• Increased global risk aversion toward emerging markets could lead to slower growth in commercial real estate transaction volume in Latin America this year. Transaction volume varies by country and is closely tied to the local economic climate.

• Scarce supply and steady demand should sustain a healthy level of activity for prime real estate in Brazil, which dominates transaction volume in the region. Transaction activity is growing in secondary cities, where development is on the rise to cater to the growing consumer class in previously underserved markets. However, activity could slow if the economy lags.

• Improving business and consumer confidence in Mexico has buoyed economic growth, increasing demand in the office and retail sectors. Mexico’s industrial sector has strong fundamentals, although the performance varies by city. Markets in central and northern Mexico are benefiting from investments by manufacturers.

• Chile’s strong domestic economy has boosted demand for real estate, and transaction volume is recovering at a rapid pace. The pace of activity may slow somewhat this year as economic growth approaches more sustainable levels.
Economic Trends

Growth Steady in Mexico and Chile, Brazil Faces Challenges

- Growth in Mexico continues to surprise on the upside. GDP grew by 3.9% in 2011, and is expected to remain stable for the next two years (CHART 1).
- Chile’s 6% GDP growth rate topped major Latin American economies in 2011. The country is expected to stay on top on 2012, although growth is expected to moderate to a more sustainable 4%.
- Brazil’s growth dropped to 2.8% in 2011, as the industrial sector was hit with declines in manufacturing and commodity exports due to the weak global economy.
- Policymakers must find ways to address Brazil’s competitiveness in global markets, which is affected by two main factors: currency appreciation and rising labor costs. In recent years, the flow of foreign capital into the country and increasing wages have produced high inflation. Appreciation of the Brazilian real most likely will remain a long-term trend. The rising cost of local products benefits imports at the expense of exports.
- The Brazilian government launched stimulus programs in April in an effort to boost growth. The stimulus includes: eliminating a payroll tax for employers in industries that were hard-hit by a surge in imports and rising labor costs, and expanding subsidized lending by state development bank BNDES to boost exports and investment. The effort comes on the heels of a package last year that imposed higher tariffs and import volume on some products.
- Unemployment rates are dropping in Brazil and Chile, while Mexico’s employment rate has been fairly steady. Unemployment rates in these three countries range from 5.3% to 6.4% (CHART 2).

Source: IMF, INEGI, IBGE, INE, Prudential Real Estate Investors
Economic Trends

Central Banks Changing Course in Brazil and Chile

- Inflation is steady in Mexico despite a weakness in the peso that was triggered by the eurozone debt crisis and a global retreat from emerging market assets.
- After appreciating 8.7% against the US dollar in 1Q12, the peso lost some ground in April amid renewed global uncertainty.
- Inflation has slowed in recent months in Brazil, falling to 5.6% in February 2012 (CHART 3). That should enable the central bank – which is increasingly concerned about growth – to keep cutting interest rates (CHART 4). Rates topped 12% last year, and were cut to 9.75% in March.
- The challenging global economic environment prompted Chile's central bank to reduce rates in 1Q12. Inflation, at 4.4%, is higher than expected so further cuts will be judged in the context of inflationary pressures.
- Price stability in the region has improved in recent years due to the efforts of Latin American policymakers. This is important for commercial real estate, since fundamental elements of the sector – such as rental rates, property values and investment returns – are tied to inflation. Greater stability reduces the overall level of risk and enables market participants to produce more accurate forecasts and projections.

Source: Central Banks of Mexico, Brazil and Chile, Prudential Real Estate Investors
Property Markets

Low-Income Housing Continues Positive Trend

- Demand for low-income housing in Mexico and Brazil is supported by steady population growth, a relatively young population and a large housing deficit. Combined with support from government programs, these factors should sustain demand in the coming years.

- Demand for low-income housing in Mexico should be boosted by new programs and regulations approved by Mexican authorities late last year.

- Infonavit, Mexico’s largest mortgage originator, issued 130,832 credits in 1Q12, putting it on line to achieved its 2012 goals (CHART 5).

- Bond issues by Mexico’s government housing programs – including the Cedevis by Infonavit and TFovis by Fovissste – have been in high demand in both national and international markets (CHART 6).

- Growth in bank credit to housing in Brazil remains high, which is helping to support the growing middle-income housing sector. The second phase of government housing program Minha Casa Minha Vida granted 457,000 credits as of December 2011, or 23% of its goal of 2 million units by 2014.

- In Mexico and Chile, bank credit is growing at more sustainable levels, although the sector would benefit from increased access to credit in both countries.

- After a couple of years in which home values grew by more than 30%, the pace of housing inflation is expected to fall to 10-15% in 2012, which would dampen new supply. Homebuilders in Brazil are focusing on profitability, generating cash and deleveraging rather than maintaining the growth rate registered in recent years.

Source: INFONAVIT, Central Banks of Mexico, Brazil, Chile, Prudential Real Estate Investors
Property Markets

Retail: Outlook Improving Across the Region

- Tight labor markets in Brazil and Chile are keeping consumer confidence high despite an overall moderation in economic activity. Retail sales growth has cooled from the double-digit increases of early 2011 (CHART 7). Sales are expected to further moderate this year as a result of a slowdown in job creation and wage growth.

- Retail sales in Mexico are improving at a stronger rate than in 2011. Mexico’s retail sales’ growth rate exceeds the growth rate in Chile for the first time since early 2008.

- The growth of the emerging consumer class and low retail market penetration in Brazil continues to attract both domestic and international interest. Shopping center sales in Brazil grew an estimated 19% last year, with more than 20 new shopping centers added to the market. This year, 44 new shopping centers are scheduled to open, and sales are expected to increase by 12% from 2011 (CHART 8).

- Shopping center development has begun to spread to secondary cities of Brazil, which were largely ignored by developers in the past. However, these cities are becoming more attractive sources of demand as the Brazilian consumer class expands.

Source: INEGI, IBGE, INE, ABRASCE, Prudential Real Estate Investors
Property Markets

Office: Strong Employment Climate Keeps Demand Robust

- Latin American office markets have fared well despite the uncertain global economic environment. Performance is strong in Sao Paulo and Santiago while Mexico City is slowly but steadily recovering from the 2008 downturn.
- The strong employment climate in Brazil and Chile has led both domestic and international companies to expand their workforces. Vacancy rates in the main office markets of Sao Paulo and Santiago are at or near historic lows, while Mexico City and Buenos Aires registered a downward trend throughout last year (CHART 9).
- Demand for office space in Sao Paulo has been robust enough to keep up with a large amount of new supply, and rents have remained fairly steady at high levels. Deliveries are expected to increase this year as companies continue to expand or search for better-quality space. The majority of new construction is focused on prime office space, which is scarce.
- The steady delivery of new space has kept vacancy levels high in Mexico City, despite strong absorption. Rents are growing steadily (CHART 10).
- Santiago continues to show solid performance, with low vacancy rates, steady rent levels and strong tenant appetite for better-quality space.

Source: CBRE, Prudential Real Estate Investors
Property Markets

Autos Driving Demand in Mexico; Brazil’s Industrial Market Strong

• Manufacturing activity in Mexico is growing, boosted by robust auto production. Auto production grew 9.4% in the 1Q12 YOY after a 5.8% YOY gain in 2011 (CHART 11). Meanwhile, auto exports are growing at a double-digit pace.

• Although the US remains the main destination for Mexico’s auto exports, a growing number of cars are being sold in Latin America, Canada and Africa.

• New investments by automakers are increasing demand for industrial real estate. Ford announced a US$1.3 billion investment in its assembly plant in Sonora, northern Mexico. Most other recent foreign investments have been concentrated in central Mexico.

• Vacancies in Mexico’s main industrial markets of Mexico City and Monterrey continue to fall (CHART 12), buoyed by low rent levels and increased leasing activity. Rents are starting to slightly rise due to lower vacancies and a slow delivery of new space.

• Strong demand for premium space in 2011 drove the class-A vacancy rate in Brazil’s main industrial markets of Sao Paulo and Campinas to historical lows. The expansion of both domestic and multinational firms in Brazil has increased demand for better-quality industrial space.

• Brazil’s industrial market is strong. There is steady demand for class-A product, which is in scarce supply.

Source: INEGI, CBRE, Prudential Real Estate Investors
## Attractive Risk-Adjusted Investment Opportunities — Latin America

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<th>THEME</th>
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| Scarcity of Quality Affordable Housing | • Mexico — Housing sales are supported by well-established mortgage programs and favorable demographics, which creates an opportunity to invest with large local homebuilders. New government initiatives that support low-income housing development confirm the government’s interest and position the sector for sustainable growth over the short- and medium-term.  
  • Brazil — Government programs have expanded access to credit over the past five years, fueling growth of the housing market. A large housing deficit, population growth and expansion of the middle class drive new developments and prices. National expansion is attractive, albeit with execution risks.  
  • Chile — The housing market developed on the back of a well-functioning mortgage system, and is expected to show stable growth, especially in the capital city of Santiago. |
| Expanding Business Generating Demand for Logistics | • Mexico — Mexico’s prime location and competitive pricing have strengthened its position in production and distribution of goods bound for the US in wake of the financial crisis. Recent foreign direct investment figures confirm investors’ confidence in Mexico’s manufacturing sector.  
  • Brazil — The expansion of local and international companies in Brazil is generating demand for new logistics space. The quality of existing stock is poor, which presents opportunities for new development. |
| Office Development                 | • Mexico — A good entry point due to low pricing, although a large existing stock in certain areas could pose a vacancy risk. The quality of tenants is strong, and credit is available from local banks.  
  • Chile — Expanding companies are seeking new office space despite the recent delivery of large buildings. The 2010 earthquake encouraged tenants to migrate to newly-constructed buildings. |
| Retail Development                 | • Mexico, Brazil, Chile — A growing consumer class and low retail penetration outside of large cities have created opportunities for retail development in secondary cities. |
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