Foreign Investment in Latin American Real Estate: A Comparison of Argentina, Brazil and Mexico

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Abstract

A common misconception is that Latin America is one homogeneous market. In reality each Latin American country has unique characteristics with sectors that collectively span much of the risk/reward spectrum. For example, Mexico is perceived to be highly correlated with the United States while Argentina and Brazil seem less so. On the other hand, the interrelation between these economies is also significant. Economic crises in Mexico, Brazil, and most recently Argentina have had important effects throughout the region.

Many real estate investors simply view Latin America as a land of economic trouble. Yet several outsiders are starting or continuing to seek investment opportunities in the region. The purpose of this thesis is to analyze and compare, from the viewpoint of a foreign investor, three major real estate markets in the region: Argentina, Brazil, and Mexico. The paper will attempt to explain how the real estate "game" is played in each country, what the specific risks are for the foreign investor, and how investors are currently seeking to maximize risk-adjusted returns in these markets.

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1 INTRODUCTION

A common misconception is that Latin America is one homogeneous market. In reality each Latin American country has unique characteristics with sectors that collectively span much of the risk/reward spectrum. For example, Mexico is perceived to be highly correlated with the United States while Argentina and Brazil seem less so.

On the other hand, the interrelation between these economies is also significant. Mexico, Brazil, and most recently Argentina have experienced economic crises with far reaching effects. In December 1994, the devaluation of the Mexican peso provoked a sell-off of bonds throughout the region. In January 1999, the devaluation of the Brazilian Real was a major blow to Argentina's exports as well as the incomes of Argentine real estate companies with Brazilian interests (i.e. IRSA). Currently, Argentina is suffering from a three year recession, a growing budget deficit, and political uncertainty. The effects of a default on its foreign debt could have a disproportionate impact on global markets because its debt makes up about one-fifth of the supply of widely traded emerging-market bonds[1]. "Although Mexico is a safer haven for investors, it can't be fully insulated from what's happening in Argentina," said Thierry Wizman, global emerging markets strategist at Bear Stearns[2]. As evidenced by the effects on US capital markets of Russia's 1998 default, it is perceivable that a default by Argentina could have far reaching affects. Capital markets are now "truly global - inextricably linked and interrelated," as mentioned by Ric Lewis of Curzon Global Partners.[37]

[1] Wall Street Journal, July 16, 2001
[2] Wall Street Journal, July 19, 2001

Many investors see Latin America as a sea of economic trouble. Yet several outsiders are starting or continuing to seek investment opportunities in the region. The purpose of this thesis is to analyze and compare, from the viewpoint of a foreign investor, three major markets in this region: Argentina, Brazil, and Mexico. The paper will attempt to explain how the real estate "game" is played in each country, what the specific risks are for the foreign investor, and how investors are currently seeking to maximize risk-adjusted returns in these markets.

This thesis describes the real estate markets in Argentina, Brazil and Mexico both from the perspective of the local environment and the potential for direct foreign investment. As this is a very broad topic, we have generally chosen to focus on distinct areas: commercial real estate (as opposed to the housing sector), major cities (rather than smaller nodes of activity), and foreign investors (as opposed to local groups). We have carried out our research in part through interviews with the major participants in each market.

Brief Outline:

Chapter 2 presents the regional background necessary for understanding each market. The topics covered include foreign direct investment in the region as a whole, as well as the status of international trade between the region and its major trading partners. Also covered are the cultural considerations that affect the way the real estate industry functions in these markets.

The third chapter is then a top down analysis of each country from basic facts, demographics, political structures and economic indicators, to structural and legal issues that relate to real estate.

Chapter 4 outlines some current thinking on international real estate investment, specifically the foreign risk premium. The chapter then outlines the specific risks for the foreign investor as well as the strategies they use for minimizing risk. The section also presents the strategies of the major foreign investment players in the region. Finally, the chapter outlines the current opportunities for the foreign investor in this market and maps out the investor's "exits" that are currently available.

The last chapter summarizes the key issues described in the previous chapters.

2 *Regional Overview*

In the early 1990's foreign investment increased dramatically in the region, attracted by significant liberalization efforts, which included the privatization of major government owned industries, reduction of trade and investment barriers, modernization of the legal and regulatory environment, and fiscal policies aimed at reducing inflation. During the same period, investment in the real estate by foreign players followed the total foreign direct investment (FDI) volumes. For example, international developers followed multinational companies, such as Bell and Coca-Cola, as they expanded operations to the region.

By the mid-90's Mexico, Argentina and later Brazil, had stabilized their levels of inflation and seemed to attain a macroeconomic level of stability. However, they were incapable of avoiding corruptive practices and reducing unemployment as they all relied heavily on internal consumption. Furthermore, emerging market crises in the mid to late 1990s significantly changed capital flows to the region.

Latin America is facing in 2001 a more uncomfortable scenario due in part to the slowdown of the US and its effect on the global economy. This general slowdown has tapered foreign investment, exacerbated the internal problems and raised the perception of risk of each country. The same is affecting both the flow of exports and the possibility for these countries to locate affordable sources of capital. The effects on the real estate markets will be discussed in the Chapters to follow.

2.1 Foreign Direct Investment

The slowdown in these economies has brought together a slowdown in foreign direct investment (FDI). Until 1990 the region attracted relatively modest foreign investment because of its historical economic and political instability. The region saw an emergence in FDI to a peak of nearly $77 billion in 1999 (see Table 2.1).

The net FDI for the region is estimated at $57 billion for year 2000. FDI in Latin America and the Caribbean dropped by 20% from the previous year's figure of $77 billion, the first decrease of the decade (see Figure 2.1). As the UN Comisión Económica para América Latina y el Caribe (CEPAL) points out, several of the large inflows recorded for 1999 were the result of a limited number of major acquisitions of Latin American companies by foreign corporations (for example: YPF in Argentina by Repsol and Endesa in Chile).[3] In addition, close to 60% of total foreign capital inflows was concentrated in just two countries: Brazil and Mexico. Brazil was the leader in year 2000, accounting for 40% of total FDI inflows to Latin America. FDI flows were generally used for the acquisition of existing assets, primarily in services sectors (telecommunications, energy and finance).

Table 2.1: Foreign Direct Investment

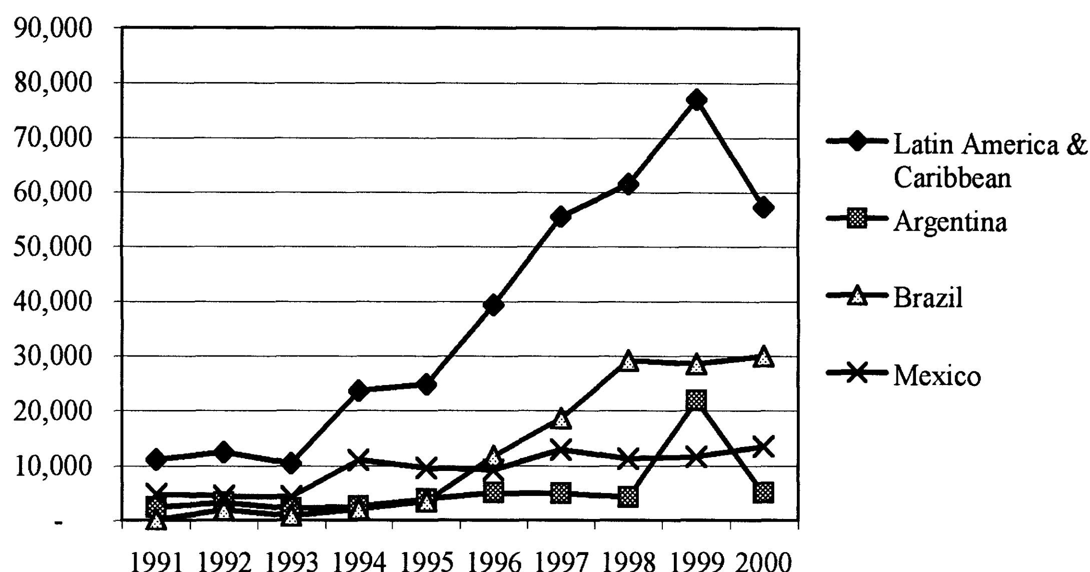
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Latin America	11,066	12,506	10,363	23,706	24,799	39,387	55,580	61,596	77,047	57,410
Argentina	2,439	3,218	2,059	2,480	3,756	4,937	4,924	4,175	21,958	5,000
Brazil	89	1,924	801	2,035	3,475	11,666	18,608	29,192	28,612	30,000
Mexico	4,742	4,393	4,289	10,973	9,526	9,186	12,830	11,311	11,568	13,500

Source: Preliminary Overview of Latin America and the Caribbean, 18th April 2001, ECLAC, United Nations[4]

[3] Comisión Económica para América Latina y el Caribe (CEPAL): La inversión extranjera en América Latina y el Caribe Informe 2000, April 2001

[4] http://www.eclac.org/

Figure 2.1: Foreign Direct Investment



Source: Preliminary Overview of Latin America and the Caribbean, 18th April 2001, ECLAC, United Nations[5]

As detailed in the CEPAL report, during the past decade several trends have affected foreign investment in the region, such as increased transnational activity, mergers and acquisitions, and the shift of ownership in the banking industry.

2.1.1 Transnational activity:

Industrial ownership has become "transnationalized" in recent years. Foreign corporations increased their share of the total sales of the region's 500 largest firms from 27% to 43% from 1990 to the end of the decade. During the same period, private domestic firms' share remained under 40%, while state companies saw their share fall from 33% to 19%. Some examples include the participation of Spanish corporations such as Telefonica and Iberia in several Latin American industries. In the power generation sector, Endesa España in Chile and the American

AES Corporation in Argentina, Brazil, Chile and Venezuela were examples of major activity. Repsol's purchase of YPF shares from private investors in 1999 was another major transaction in primary sector. In terms of the 200 largest exporting firms, transnationals' share rose from 29% to 41% between 1995 and 1999; private domestic firms' share fell from 37% to 33%, and state firms' share fell from 34% to 26%.[3] In the real estate office market, the increased presence of transnationals has driven the demand for higher quality space over the same period.

2.1.2 Mergers & Acquisitions:

Mergers and acquisitions (M&A) activity has increased dramatically in the past decade in not only developed countries but also emerging markets such as Latin America. In the past two years, M&As of private companies occurred mainly in the service sector, followed by the primary sector, and then manufacturing. One of the largest transactions was by Telefónica de España, which increased its controlling interest to almost 100% of its subsidiaries in Argentina, Brazil and Peru, thus becoming the largest transnational company in Latin America, according to the CEPAL report.

2.1.3 Banking Sector:

Major consolidations took place in Latin America's banking sector. Spanish banks Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA) in Argentina, Brazil, Chile and Mexico made large purchases. There have also been several foreign acquisitions of large Mexican banks, most recently the $12.5bn purchase of Banamex by Citibank of the US in May 2001, over 50% of the FDI originally projected for the year 2001. Following this latest acquisition, 80% of the Mexican financial system is now in foreign hands, a

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[5] http://www.eclac.org/

long-term trend in the entire region that began with the sale of Banco Real to ABN Amro in Brazil in 1998.[6] As stated by Moody's Investor Service, the "effects of globalization and recurring financial crisis – as well as certain cultural and governance aspects of the remaining mega-banks- are shaping the future of banking in Latin America and are pushing inexorably towards greater consolidation and foreign control."[6]

2.2 International Commerce

For Latin America the North American market represents more than half of its goods, followed in order of importance by the inter-regional commerce, followed by the EU, and the Asian countries. These numbers are influenced by the Mexican figure, which are the source of over half of the region's exports. Mexico has a dependency of nearly 85% on the US for its exports. The same occurs with the countries of the Andean countries (Venezuela, Peru, Colombia) due to the export of petroleum, and Central America with the Maquiladora industry. Very different is the structure of the commerce of exports in Mercosur, particularly with Argentina and Brazil, in which 35% go throughout Latin America, followed by the EU (25%), then the US (15%), and Japan and Asia (13%).

[6] Moody's article: "The Fall of Bancomer and the Future of the Indigenous Mega-Banks in Latin America"

Table 2.2: Trade Partners

	Brazil (1999)		Mexico (1999)		Argentina (2000)	
	Country	**%**	**Country**	**%**	**Country**	**%**
Exports	US	22.6	US	83.2	Mercosur	32.0
	Argentina	11.2	Canada	5.2	NAFTA	14.2
	Netherlands	5.4	Japan	1.3	EU	17.5
	Germany	5.6	Spain	1.1		
	Japan	4.6				
Imports	US	24.1	US	74.8	Mercosur	28.6
	Argentina	11.8	Germany	3.9	NAFTA	22.4
	Germany	9.6	Japan	3.8	EU	22.9
	Italy	5.3	Korea	1.6		
	Japan	5.2				

Source: EIU

2.2.1 Trade Agreements:

Mercosur

The Mercado Común del Sur (Mercosur) is a customs union established on January 1, 1995 that is comprised of Brazil, Argentina, Paraguay and Uruguay and two associate members (Bolivia and Chile). The market represents over 230 million people and combined GDP of over $1.2 trillion. Mercosur is the third-largest trading bloc in the world after the European Union and NAFTA. From 1990-1996 intra-group trade grew at an annual rate of 22%, to a value of $16 bn, net foreign direct investment increased 33% per year reaching more than $40 bn during the period.[7]

However, the unilateral decision of Brazil to devalue and float the Real has strained relations within the trading bloc, especially with Argentina, a chief exporter to Brazil. Likewise,

Argentina's recent emergency measures have called into question the future of the trade group. There does not seem to be a consensus among the countries on the issue of currency. Chile recently dropped its application for full membership of Mercosur and announced it would seek a bilateral agreement with the US instead. Certainly, the outlook is not especially bright for the trading bloc, reflected by the sentiment of one real estate player in the market: "Mercosur is dead…Argentina killed it and it was Brazil's fault."[8]

North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement (NAFTA) was implemented on January 1, 1994 with the objective of removing most of the barriers to trade and investment among the United States, Canada, and Mexico.[9]

NAFTA opened previously protected Mexican industries (such as financial services) to foreign investment, improved the legal environment for foreign investors and, by lowering tariffs on trade between Mexico and the US and Canada, allowed companies from developed countries to use Mexico as an export platform, taking advantage of the country's pool of low-cost labor and proximity to the US market. Efforts to open up ports, railways, airports and gas distribution, combined with increased macroeconomic stability in the second half of the 1990s, have also resulted in increased foreign investment.[10]

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[7] http://www.mac.doc.gov/ola/mercosur/
[8] Karl Trieschman, AIG Buenos Aires
[9] http://www.fas.usda.gov/info/factsheets/nafta.html
[10] http://www.mac.doc.gov/nafta/

NAFTA has helped launch Mexico as a world player, trailing only Brazil in terms of emerging market FDI worldwide. Since the establishment of the trade agreement, Mexican exports to the US have increased to 88% in 1998, placing it among one of the world's leading exporters.

Free Trade Agreement of the Americas (FTAA):

The process leading to the conclusion of a Free Trade Area of the Americas (FTAA) was initiated in Miami in 1994 at the first Summit of the Americas. The 34 countries attending the Summit committed themselves to the establishment of a free trade zone in the Americas by the year 2005. Formal negotiations were launched in Santiago in 1998 with the aim to create a huge free trade area stretching from Alaska to Patagonia, with a combined GDP of more than $10,000 billion and a market of 800 million consumers.[11]

2.3 Cultural Considerations

An important yet sometimes neglected consideration for the foreign investor in Latin America is an understanding of the cultural distinctions that affect how the real estate game is played. This section presents two of the more commonly given differences between this region and the US.

2.3.1 "Latin Americans love real estate"

Historically, Latin Americans have had a view of real estate quite contrary to that of North Americans. Property in this region is less seen as something tradable and transitory, but rather as a more permanent investment. Why is this the case? One possible reason is that generally speaking middle and upper class people in Latin America change homes less than their

[11] http://www.ftaa-alca.org/

counterparts in US. Perhaps due to the lack of transportation infrastructure, developments in these countries are highly concentrated in urban agglomerations.

Many point out that Latin Americans are in general more family oriented than in North America. For example, it is typical for sons and daughters to live at home until marriage, as opposed to the US where it is more typical to move out for college or work. Because of this, people's preferences in Latin America are to move less, especially compared to the highly mobile United States where it is estimated that households move as often as once every six years.[12]

A third factor in this cultural divide is the general absence of long-term debt in the region. Real estate is usually an all equity investment for Latin Americans. The fact that real estate leases have always allowed for indexation, either by inflation or construction costs, has identified real estate as a good hedge against inflation in the local currency.

In the US the situation is generally quite different. The presence of attractive mortgage financing, which is externally linked to capital markets, has made real estate a more risky asset due to the leverage effect of debt.[13] While cheap mortgage financing makes it easier for Americans to purchase a home, the risk of the investment is increased by the presence of leverage. Americans view real estate as a riskier asset class than say, Treasury bonds, or other fixed income securities. Latin Americans, on the other hand, traditionally buy and hold real estate for its dividends (rents). Also, contrary to the US, people in this region do not view their country's sovereign debt as the "risk-free benchmark", perhaps due to historic defaults. For

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[12] Real Estate and Urban Economics, Wheaton and DiPasquale
[13] Brealey & Meyers, Principals of Corporate Finance

example, in 1982 during the nationalization of the Mexican banking sector by President Lopez Hurtado, all commercial deposits were seized and repaid in less liquid government bonds. In the eyes of the Latin American general public, bricks and mortar are seen as closest to a risk-free asset. Besides, compared with local currency denominated CD deposits at 6%, real estate yields are more attractive.

Due to the lack of debt, real estate is not linked to the capital markets like in the US. As illustrated by Fernando Bergamin of Brazil Realty, "if interest rates were to either double or halve, property prices would not change." But the perception that real estate never loses value is obviously flawed. Because people have an all equity investment and trading is generally thin, properties are not marked-to-market on a regular basis. Consequently, there is a wide and continuous bid-ask spread in the real estate investment market. Asking prices of real estate remain relatively constant because owners often believe that values remain constant. In reality, however, real estate rent and price data reflect the fact that values fluctuate, especially in times of crisis.

2.3.2 A relationship based business environment

Another important cultural consideration for the foreign investor is the attitude toward business relationships in general. This knowledge is key to understanding how the real estate game is played in these markets.

From a historical perspective, few players, either high net-worth individuals or state owned entities, have traditionally dominated these markets. With privatization and liberalization in

these countries, real estate has passed to a small number of players in the private sector (such as individuals, companies or pension funds). Together with the small market size, the relatively small number of participants has resulted in the real estate business being transacted often times through informal and personal relationships.[14]

In order to preserve this club atmosphere, and in view of the inefficiencies of their own legal systems, the real estate business is focused on trying to reach consensus rather than focusing on the legalities of the agreements. Latin American real estate is done on a relationship basis, as opposed to the US where the contract binds all business activity.

A major contributor to the current market behavior is again the lack of long term financing. According Ariel Turkie of Andean Asset Management, "the development of the real estate debt markets in Argentina lags behind that of the United States by 20 to 30 years." Due to the absence of major market arbitrators (such as lenders and secondary markets in general), agreements are bilateral as opposed to multi-lateral in the case of the US. There are generally no third parties or secondary markets which require strict, standardized underwriting. This lack of standardization affects the strategy of foreign investors since there is a great deal of "recreating the wheel" on each deal.

Property rights, land use regulation and enforcement are often not up to US standards. In many cases both legislation and enforcement are weak. Lease contracts are seen as the foundation of the real estate deal in the US, and tenants and landlords have faith that their contact will be honored in a US court. This perception is not necessarily the case in Argentina, Brazil and,

[14] Gabriel Fernandez, AIG Global Investment Group, July 2001 Interview

perhaps even today, Mexico. The lack of emphasis on solid contracts often results in leases which vary considerably from the US standard. As developer Ken Moscow exemplifies, "our office leases can be three pages long in San Jose, Costa Rica versus 40 pages in Boston."[15]

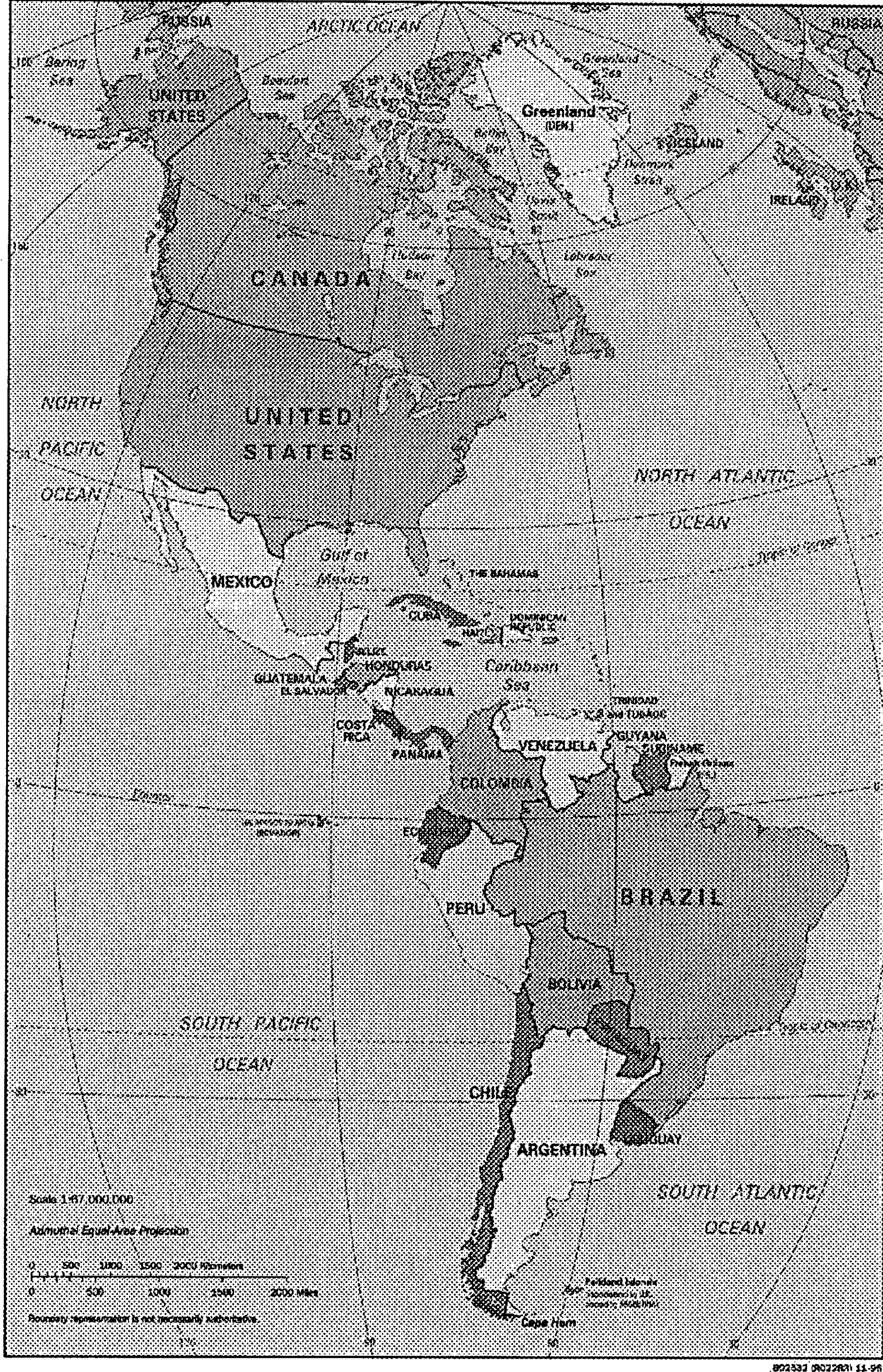
This lack of transparency, together with a different value of time, can prolong due diligence and closing of transactions. It is not uncommon for a deal to take more than a year to close. Tom McDonald refers to Equity International's acquisition of Fondo de Valores Immobillarios to illustrate this point: "it was like a cat with nine lives that was continually dying and coming back."

Conclusion

In sum, for the foreign investor in this region it is important to highlight foreign direct investment levels, which are a strong driver of real estate demand. On the other hand, cultural attitudes towards real estate ownership are also a strong factor. When times are good, FDI levels increase and foreign developers and investors follow suit. When times are bad, real estate is viewed as a safe harbor for local investors.

[15] Ken Moskow, American Venture Corp., July 2001 interview

3 *Market Comparisons*



[16]

[16] Courtesy of The General Libraries, University of Texas at Austin

The following tables and narratives provide a comparison of specific details of each country: Argentina, Brazil and Mexico. The main sources of data for this section are intelligence reports from CB Richard Ellis, Inc.[17] and the Economist Intelligence Unit.[18]

3.1 Basic Country Facts

	Argentina	**Brazil**	**Mexico**
Population	36.6m (1999)	164.0m (1999)	97.4m (2000)
Capital City[19]	Buenos Aires (pop. 13.3M)	Brasilia (pop. 1.85M)	Mexico DF (19.75M)
Other Major Cities[19]	Cordoba (1.425M), Rosario (1.27M)	São Paulo (17.9M), Rio de Janeiro (10.65M)	Guadalajara (4.1M), Monterrey (3.6M)
Area	2,737,000 sq. km	8,547,403 sq. km	1,953,162 sq. km
Population Density	13 per sq. km	19.9 per sq. km	50.98 per sq. km
Official Language	Spanish	Portuguese	Spanish
Literacy Rate	96% (1995)	83% (1996)	90%
Infrastructure			
Railways	35,753 km	26,895 km	26,595 km
Roads (paved)	42,282 km	184,140 km	108,803 km
Waterways	11,000 km navigable	50,000 km navigable	2,900 km navigable
Pipelines			
Crude oil	4,090 km	2,000 km	28,200 km
Petroleum products	2,900 km	3,804 km	10,150 km
Natural gas	9,918 km	1,095 km	13,254 km
Land Use	73% cattle breeding; 4% arable crops; 18% mixed-use; 5% other	58% forests/woodlands; 22% permanent pastures; 5% arable land; 15% other	57% pastures; 21% arable land; 17% forests; 5% other
Land Area	2.7m sq km	8.51m sq km	1.9m sq km

3.2 Demographics and Domestic Wealth

The demographics in this region are one of the bigger drivers of demand for real estate and interest of foreign investors. The current median age in Latin America is expected to increase to over 32 years in the next 20-25 years. "This is not only a young population, but a young one that

[17] CB Richard Ellis Latin American and Caribbean Headquarters, Country Intelligence Report and Real Estate Market, October 2000
[18] Economist Intelligence Unit, ISI Emerging Markets, Internet Securities, http://site.securities.com/
[19] Brinkhoff: Principal Agglomerations of the World, http://www.citypopulation.de

is entering the workforce, and will be earning more in the next 5 or 10 years", according to Charles Lowery of Prudential Real Estate Investors.[20]

Mexico is the youngest of the three countries, with a median age of 22.8, followed by Brazil at 25.6, then Argentina at 28.8. To put these figures in perspective, the median ages of North America and the EU are 30.6 and 37.6, respectively.

The population growth in these countries is also a positive trend. The age 20 to 59 segment of the population is currently expanding at a rapid rate, and is expected to continue growing rapidly during the next ten years. Census data allows a projected growth rate of 2% annually in the coming 5 years and 1% annually in the next 5 years.[21]

	Argentina	**Brazil**	**Mexico**
Population Growth	1.3% per year (1995-99)	1.3% (average, 1995-99)(a)	1.3% (average, 1996-2000)
Age Structure			
Below 15 years	29.4%	31.6%	34%
Between 15-64 years	61.1%	63%	62%
Age 65 and older	9.5%	5.4%	4%
Life Expectancy	73 years	67 years	71.5 years
Median Age 2000[21]	28.8	25.6	22.8
Median Age 2025	35.0	35.2	31.8
Average Household Buying Power[22]	$19,989 Buenos Aires: $23,798	$7,132 São Paulo: $14,527 Rio de Janeiro: $8,182	$20,679 Mexico DF: $30,959 Monterrey: $23,702

Domestic wealth in the region has increased disproportionately between rural areas and urban agglomerations. For example, the average household buying power (or, the average amount each

[20] http://www.excelsior.com.mx/0104/010405/fin05.html
[21] Prudential Real Estate Investors, US Census Bureau
[22] Prudential REI, Latin America 2001; Strategy Research Corporation, http://www.strategyresearch.com/pdf/july2001.pdf

household could spend on an annual basis) in urban Brazil is $8,192, compared to an average rural household buying power of $2,920. In the region as a whole, the average urban buying power is $11,352, versus a rural average of $6,552.

3.3 Political Structure and Climate

Argentina:

Argentina's presidential system is checked by a bicameral Congress comprising a 257-member Chamber of Deputies, representatives of which are elected for four-year terms, and a 72-member Senate, to be directly elected from 2001. The president serves a four-year term. The ruling Alianza coalition, formed by the UCR and Frepaso, has a precarious position in Congress. It is the largest force in the lower house, but lacks a majority. The PJ has a majority in the Senate at least until the 2001 mid-term elections and also controls the important governorships, thereby representing an impediment to governability.[18]

In the early 80s, Argentina suffered from economic stagnation and hyperinflation. In 1983 the first democratic government came into power, ending many years of military rule. In 1989, Carlos Menem of the Partido Justicialista was elected president based on a populist campaign. However, once in power, he abandoned the party's ideology. The Peronists' policy of liberalization and privatization attracted foreign investment into the country. This period of rapid growth was undermined by Menem's failure to execute fiscal and structural reforms, leaving the country vulnerable to the Asia Crisis, followed by Russia and then Brazil. Argentina entered into a recession and experienced almost no growth in 1999 and 2000. Unemployment also rose in the same period. In December 1999 Fernando de la Rua succeeded Menem. Mr. de

la Rua's term has been marred by bribery scandals and political fallout, including the resignation of the vice president. This, combined with the ongoing recession and fears of default, were part of the reason why in March 2001 Menem's former economy minister, Domingo Cavallo, was brought back into office. With emergency powers from Congress, Mr. Cavallo has become the central figure in Argentine politics.

Brazil:

Democratic rule resumed in Brazil in 1985 and a new constitution was ratified in 1988. The president executes policy approved by the 513-seat Chamber of Deputies and the 81-seat Senate, with constitutional review by an independent judiciary. Although the president wields considerable power and can resort to temporary decrees to push through legislation, the provisions of the 1988 constitution give Congress ample capacity to frustrate the executive.

Brazil's current president, Fernando Henrique Cardoso, is currently serving his second term, marked by the devaluation of the Real in 1998. Major fiscal and structural reform challenges remain, but the market sentiment towards Brazil's economic recovery is considerably better than in neighboring Argentina. Nonetheless, Corruption scandals and an energy crisis are threatening to undermine the government as it enters the second half of its term. Several ministers and the former leader of the Senate have been forced to resign. The scandals have damaged the government's image and weakened support for Cardoso.

Mexico:

The Mexican political system is presidential, bicameral (Senate and Chamber of Deputies) and federal (32 states). The president is elected every six years and the 500 members of the Chamber of Deputies are elected every three years. In the Senate, 75% of its members are elected directly for a six-year term; the remaining 25% by proportional representation.

For the 70 year previous to the election of Vicente Fox of the Partido Accion Nacional in July 2000, Mexico was ruled by the Partido Revolucionario Institucional, or PRI. While the new president reflects Mexico's direction toward free market policies and economic liberalization, the nationalistic PRI is still the largest party in the Mexican congress. Fox started with high approval ratings with the general public, but his greatest challenge has been to pass crucial legislation in congress.

Fox is focused on deregulation and increasing the competitiveness of Mexican industry. By the end of his six-year term in office the president plans to generate 1.3m jobs per year and to boost economic growth to 7% per year. In the short term, however, this is being challenged by the economic slowdown in the US.[18]

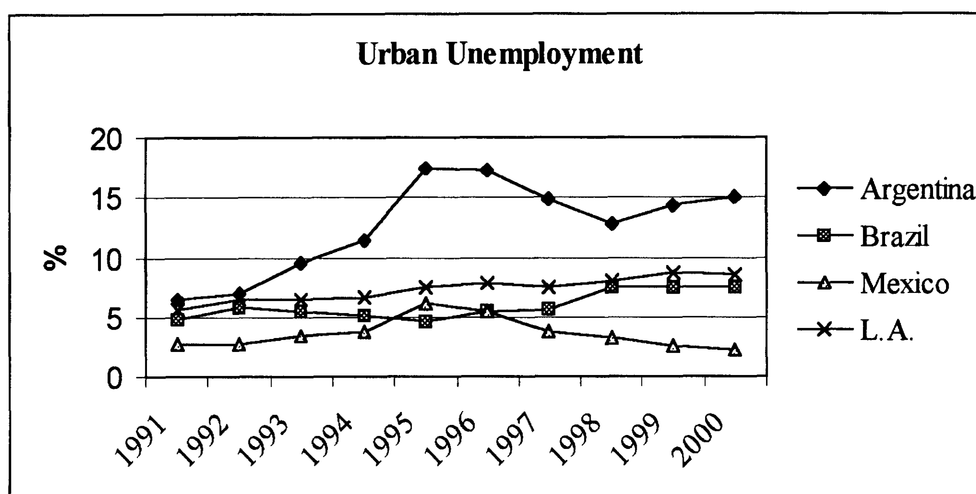
3.4 Economic Indicators and Forecasts

The following charts and graphs summarize the current status of each country's economies.
Also included are economic forecasts according to the Economist Intelligence Unit.

	Argentina	Brazil	Mexico
Currency	Ps1:US$1 (end-2000); Ps1:US$1 (May 1st 2001)	R1.81:US$1 (1999, ave); R2.489:US$1 (Aug 15th, 2001)	Ps9.46:US$1 (2000, average); Ps9.075:US$1 (Aug 15th 2001)
Inflation	-0.3% (average, 1996-2000); -0.7% (2000; year-end)	17.3% (average, 1995-99); 4.9% (1999, average); 8.9% (1999, year-end)	16.7% (average, 1996-2000); 9.5% (2000, average)
GDP:	US$277.9bn (2000)	US$529.5bn (1999, at market exchange rate)	US$561bn (2000, at market exchange rate)
GDP Growth	2.7% (average, 1996-2000); -0.5% (2000)	2.1% (average, 1995-99); 1% (1999)	5.5% (average, 1996-2000); 6.9% (2000)
GDP Per Capita:	US$7,505 (2000; market exchange rate); US$10,589 (2000; PPP)	: US$3,230 (1999, at market exchange rate)(a); US$6,937 (1999, at PPP)(a)	US$5,764 (2000, at market exchange rate); US$10,075 (2000, at PPP)

As shown in Figure 3.1, unemployment has remained relatively stable throughout the region, in Brazil and Mexico in particular. Argentina, on the other hand, experienced a tripling of it unemployment level between 1991 and 1995, and has recently leveled off at 16.4% as of May 2001.[3]

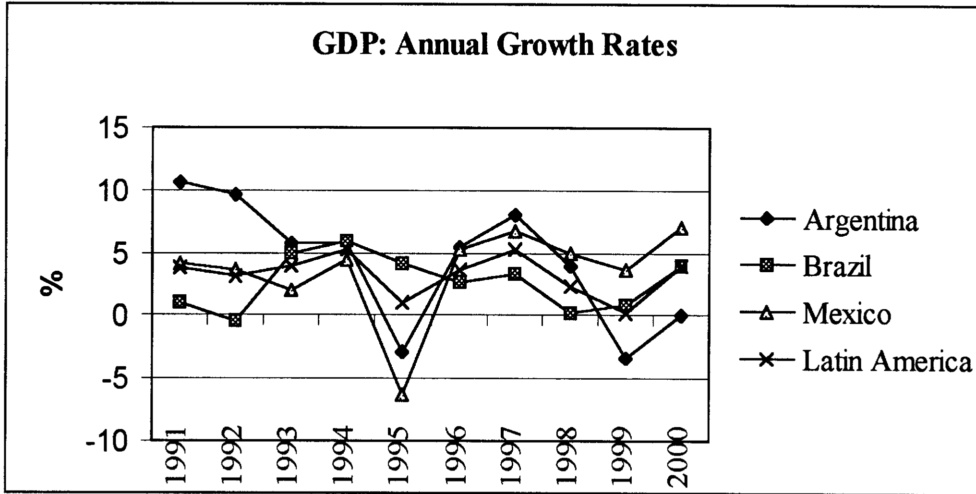
Figure 3.1: Urban Unemployment



Source: ECLAC, United Nations[4]

Gross domestic product in the region has been relatively volatile. Annual growth rates of GDP, as shown in Figure 3.2, have varied from –6.2% for Mexico to +10.6% for Argentina over the 10 year period.

Figure 3.2: Gross Domestic Product



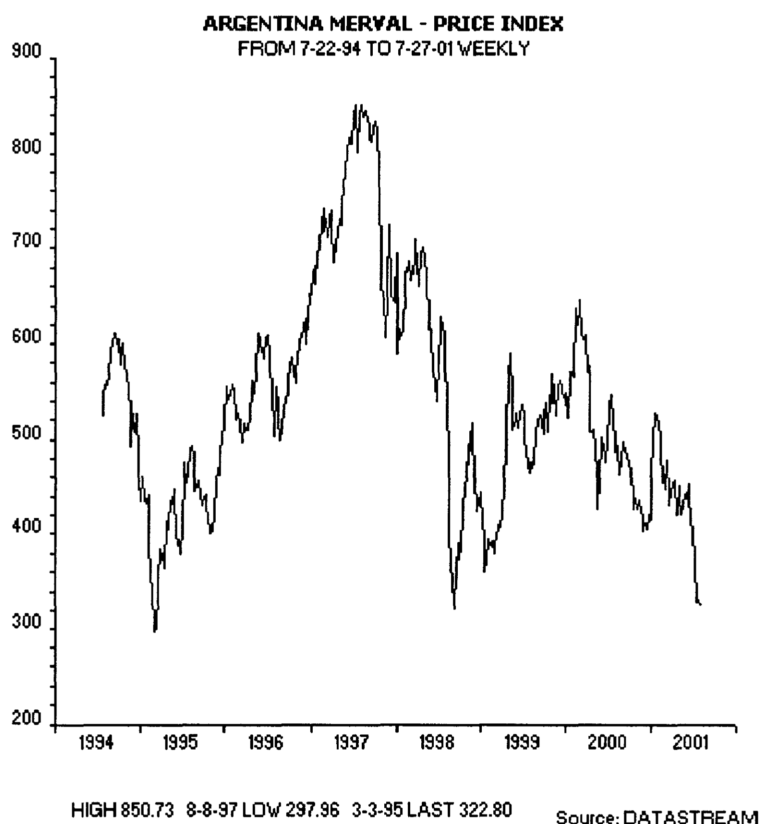
Source: ECLAC, United Nations[4]

Argentina:

After three years of recession and a series of high-profile corruption scandals (Senate Crisis, Menem's imprisonment), politicians in Argentina are facing growing public dissatisfaction. Domingo Cavallo, who became the Fernando de la Rua government's third economy minister in March 2001, has sought to promote recovery through targeted measures designed to boost competitiveness despite a high country risk premium and fears about the government's solvency. However, nervous financial markets have not been willing to wait for recovery to come. During the first two weeks of July, market jitters, along with Argentina's risk premium, increased so much that Mr. Cavallo was forced to introduce an emergency plan to slash the fiscal deficit to zero with immediate effect. Most recently Argentina's credit rating was lowered by Moody's

Investors Service to Caa1 on concern the country won't be able to erase its budget deficit to help ensure debt payments. As a result of the spending cuts and a negative external environment, a return to economic growth in 2001 is unlikely.

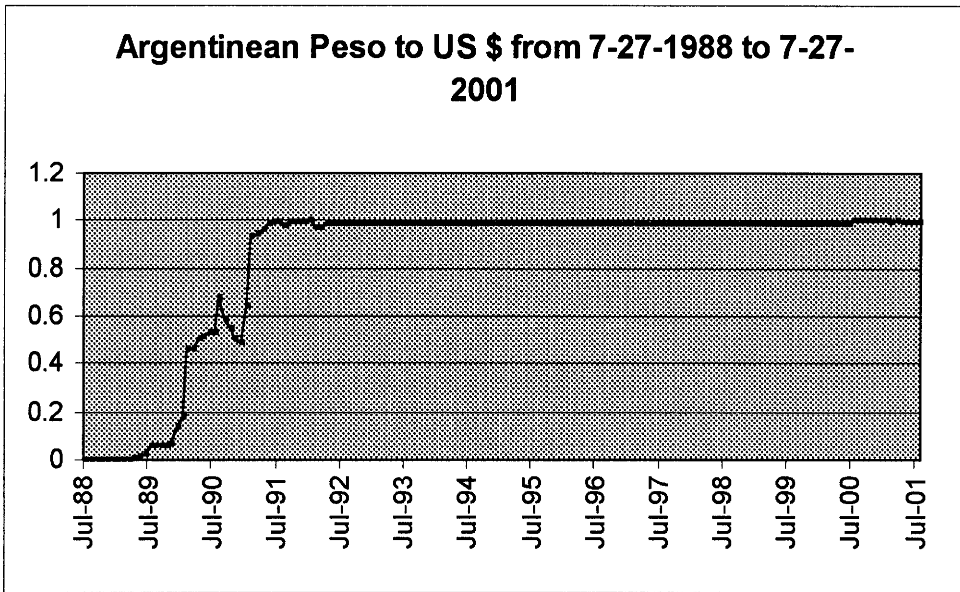
Figure 3.3 Argentine Stock Market



Output growth is forecasted be flat in 2001, the result of severely restricted access to financing, high interest rates, the slump in investment and adverse external conditions. The several years have been extremely volatile for the Argentinean stock market, the Merval (see Figure 3.3). This volatility is projected to persist at least into the near future.

Despite the weaker exchange rate introduced for trade transactions in June, the EIU does not expect any immediate change to the official one-to-one parity with the dollar. Though the rigidity of the dollar peg hinders market efficiency by maintaining unnaturally high prices, affecting Argentine exports to both Europe and Brazil, whose currencies have lost against the dollar since late 1998.

Figure 3.4: Argentine Currency



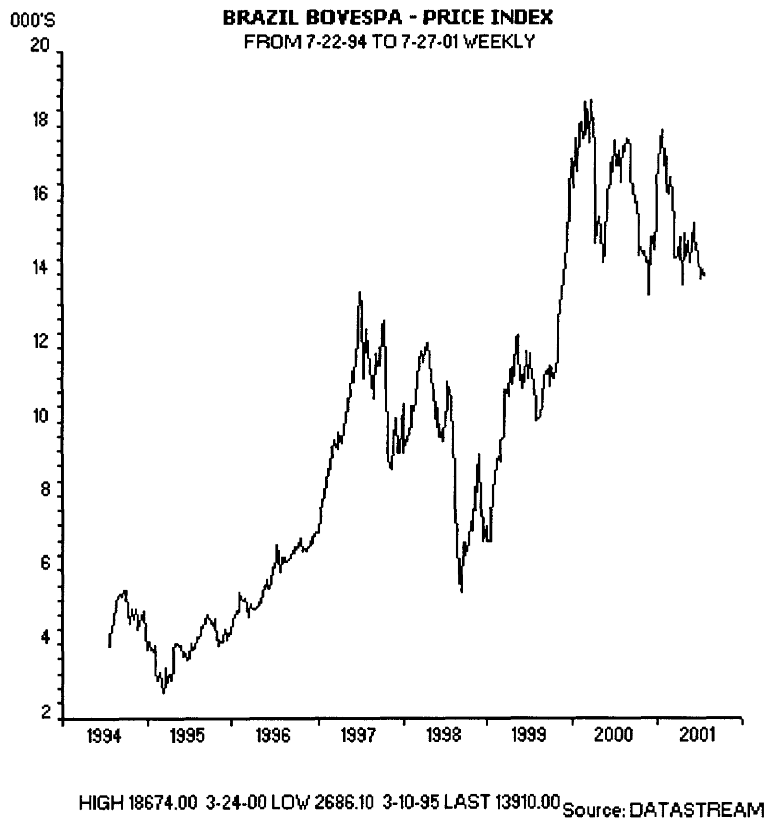
Source: Datastream

Brazil:

Brazil's economic prospects have been adversely affected by pressures on the Real caused by worries about Argentina and instability in global financial markets. These problems have already forced the Banco Central do Brasil to raise interest rates by 150 basis points in recent months to 16.75%. Further tightening cannot be ruled out if instability in global financial markets persists or the fiscal reforms currently under way in Argentina fail to restore confidence.

The Brazilian stock market has been trending upward since 1994, with the exception of struggles between late 1997 and 1998 (see Figure 3.5). The Bovespa is by far the most active stock market in Latin America, nearly twice the size of the Mexican Bolsa[23].

Figure 3.5: Brazilian Stock Market

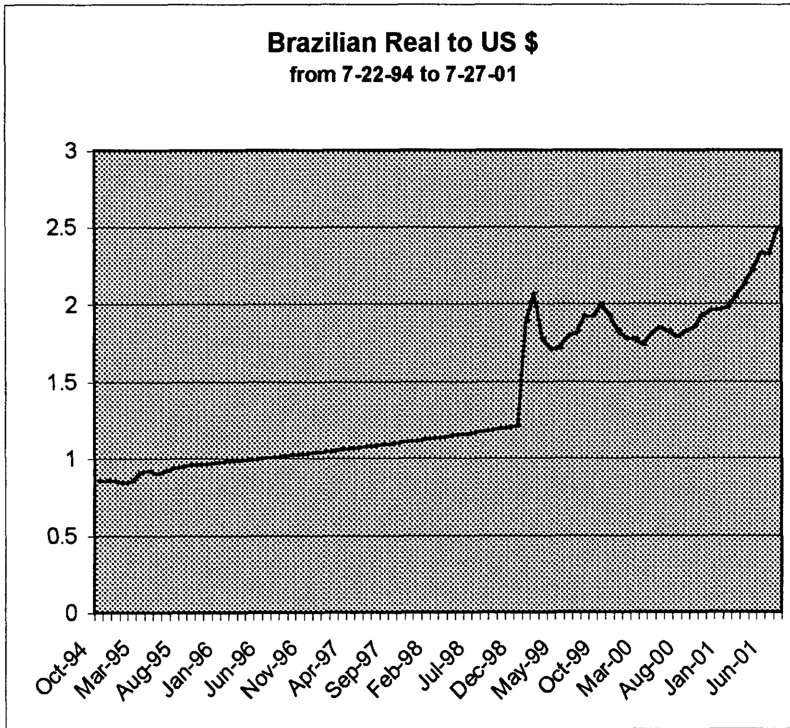


One of the strengths of the Brazilian economy was that it was able to float its currency without incurring high inflation. But the behavior of the Brazilian Real depends greatly on neighboring Argentina, in addition to other factors such as net FDI. In the case of a default by Argentina, the Real could fall much beyond the levels that followed the 1998 devaluation. The EIU forecasts that the Real could even top R3:US$1. On the other hand, the EIU notes, "if the crisis in Argentina begins to stabilize, global financial markets become less volatile and the energy crisis

[23] Emerging Stock Market Review, Standard & Poors, December 2000

begins to abate, we would expect the Real to retrace at least part of its recent depreciation, which we view as overshooting".[18]

Figure 3.6: Brazilian Currency



Source: Datastream

Mexico:

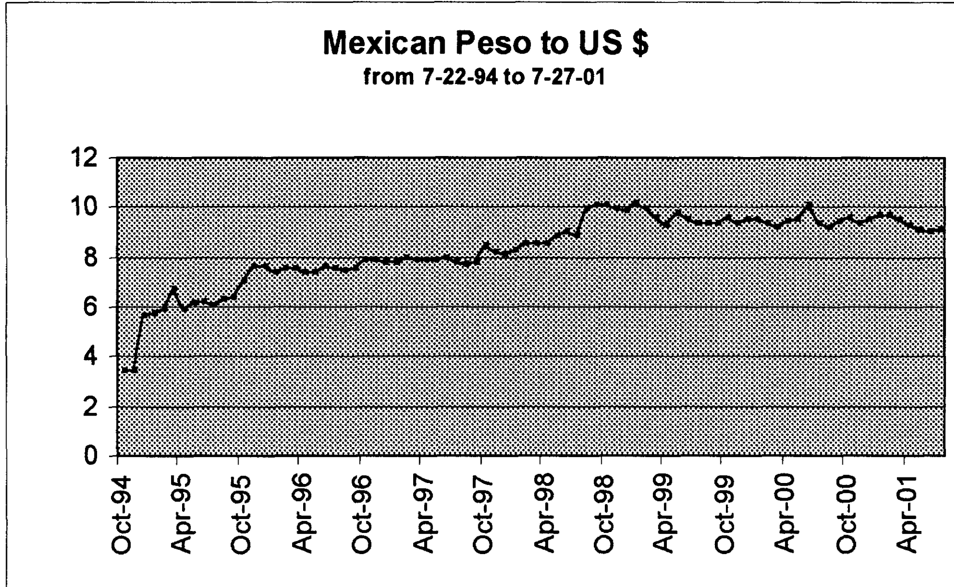
One of the critical issues for Vicente Fox is the previously mentioned fiscal reform. The legislation has been slowed recently by Congress, postponing passage until at least the end of 2001. Pass fiscal reform would significantly boost international confidence in the country and would allow Fox to pursue further privatization programs in industries such as electricity. This is one of the signs long awaited by US rating agencies to grant Mexico an investment grade debt

rating, which would attract previously untapped foreign capital (US pension funds), lowering Mexican bond yields and interest rates.

Inflation in Mexico has subsided and should continue to decline in the near future. Consumer Price Index growth in year 2000 was 9.5%, considerably lower than levels of the mid-90s. The EIU forecasts inflation to be 7% by end-2001, before decreasing further to 5-5.5% by end-2002.

The peso has been relatively stable in recent years. Its value has been backed by the inflows of dollar-denominated investments into Mexico. The general view in the market is that the currency is overvalued against the dollar and that the peso will depreciated in the near future. The current uncertainty in Argentina, and concerns related to the US, seem to point toward a softening of the currency. Although the EIU expects the peso to weaken slightly from its current position of strength, the movement will not be large enough to spark a resurgence of inflation.[18]

Figure 3.7: Mexican Currency



Source: Datastream

Perhaps triggered by an overvaluation of the peso, the Bolsa has been on a downward trend after witnessing dramatic gains from 1999 into early 2000 (see Figure 3.8).

Figure 3.8: Mexican Stock Market

Since the incorporation of NAFTA, Mexico has been kept afloat by the success of the US economy. Mexico, as its second largest trading partner after Canada, is highly dependent on US demand for its exports. The slowdown may affect one area often overlooked by analysts: dollar remittances from the millions of Latin Americans working abroad. To Mexico alone, they're worth $6 billion to $8 billion a year, trailing only petroleum exports as a source of hard currency.[24]

Having grown by 6.9% in 2000, the EIU forecasts GDP to grow by just 1.8% in 2001 as a result of a slowdown in the US. Expected recovery in the US economy will allow Mexico's growth to

accelerate to a forecasted 4% in 2002, owing to higher exports and stronger private consumption. Inflation remains well under control and is project to end 2001 at around 7%.

Table 3.1: EIU Forecasts

	2000	**2001**	**2002**	**2002**
GDP (real % change)				
Argentina	2.4%	3.0%	3.2%	3.7%
Brazil	4.0%	4.5%	4.0%	3.6%
Mexico	5.0%	3.5%	4.3%	4.4%
Consumer Prices				
Argentina	-0.6%	1.3%	1.9%	2.2%
Brazil	6.1%	4.9%	4.3%	3.1%
Mexico	10.0%	9.5%	8.3%	7.5%
Exchange Rate				
Argentina	1.00	1.00	1.00	1.00
Brazil	1.81	1.81	1.85	1.86
Mexico	9.86	10.75	11.35	11.87
Current Account Bal.				
Argentina	-13.8%	-14.1%	-12.3%	-14.1%
Brazil	-24.9%	-24.9%	-25.5%	-26.3%
Mexico	-18.7%	-23.1%	-24.9%	-26.9%

Source: EIU

[24] As US Sneezes, Neighbors Fear a Cold – the Downturn up North Could Quash Recovery of Latin Economies, WSJ via Dow Jones Interactive, 12/12/2000

3.5 Real Estate Market Fundamentals

The following table summarizes the market reports of CB Richard Ellis, Inc. for each market as of 1st quarter 2001.[25]

	Buenos Aires	**Sao Paulo**	**Rio de Janeiro**	**Mexico DF**
Total Office Stock (in square meters)	3,610,245	4,074,000	2,246,000	3,197,450
Class A Office Stock	1,373,217	N/A	N/A	1,820,818
Non-Class A Stock	2,237,028	N/A	N/A	1,576,632
Vacancy Levels – Class A	7.8%	8.0% (class A & non-class A)	0.4%	13.0
Vacancy Levels – Non-Class A	1.0%	N/A	7.0%	22.6
Net Absorption (year 2000)	145,000	109,000	N/A	350,000
Asking Rents on Class A Office Stock (per SM per year)	$27.00	R$48.00 (class A & non-class A)	R$53.00 (class A & non-class A)	$27.50
Asking Rents on Non-Class A Office Stock (per SM per year)	$13.00	N/A	N/A	$15.50
New-construction (as of May 2001)	262,419	214,000	61,000	309,154

3.6 Real Estate Structural and Legal Issues

This section compares the real estate structural issues (i.e. the rules of the game) for each market. The relevant issues are broken down into the following categories: taxes, ownership, leasing and financing. The main source of data for this section is an October 2000 Country Intelligence Report by CB Richard Ellis, Inc.'s Latin American and Caribbean Headquarters.

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[25] www.cbrichardellis.com

3.6.1 Taxes

	Argentina	Brazil	Mexico
Corporate Income Tax	35%	34%	35%
Assets Tax	1.0%	None	1.8%
Employee Profit Sharing	None	None	10%
Withholding Tax on Dividends	None	None	7.69%
Tax on branch profits	None	None	7.69%
Withholding Tax on Interest	15.05% or 35%	15%	4.9%, 10%, 15%, 21%, or 40%
Withholding Tax on Royalties	17.5%, 28% or 31.5%	15%	15% or 40%
Withholding Tax on Services	21.0%, 28.0%, or 31.5%	25%	21%, 30% or 40%
Withholding Tax on Operating Leases	14.0% or 21.0%	15%	5%, 15%, 21%, or 40%
Depreciation Allowance	2.0% buildings 20.0% vehicles 10.0% machinery 33.0% computers	4.0% buildings 20.0% vehicles 10-20% machinery 20.0% computers	5.0% buildings 25 or 71% vehicles 5-25% machinery 30.0% computers
Loss carryforward	5 years	Indefinite	10 years
VAT or sales tax	21.0% VAT	ICMS is 18% ISS is $\leq$ 10% IPI is 10-15%	15% VAT
Capital gains tax on sale of shares by non-residents	None	15% or 0% (between non-residents)	20% gross basis 40% net basis
Tax on gross receipts	Deductible from Income Tax	N/A	N/A
Tax on Interest	15% paid by local borrowers to local financial institutions or on corporate bonds.	N/A	N/A
Financial transaction tax	N/A	IOF is 0-7%	N/A
Social Security Financing Tax	N/A	COFINS is 3%	N/A
Social Integration Tax	N/A	PIS is 0.65%	N/A

3.6.2 Ownership

	Argentina	Brazil	Mexico
Type of ownership	Freehold and condominium	Freehold is most common	Freehold and Leasehold are contracted
Foreign ownership	Generally unrestricted except in certain areas of national security, such as frontier zones.	Foreign direct investors must seek approval from Central Bank; Land cannot be purchased within 150 km of the border or coasts; 750-hector limitation for foreign investment in 10 São Paulo municipalities.	Foreign ownership of land or water within the restricted zone, except through a bank trust, is prohibited. *
Public property register	Yes	Yes	Yes
Notary fees	0.75-1.5%	(no fixed percentages)	1.0% - 2.0% plus VAT
Real Estate Acquisition Tax	N/A	N/A	2.0-3.3%
Transfer tax	1.5%	N/A	N/A
Provincial stamp duty	1% on execution of preliminary sales contract, 4% on execution of notary deed of conveyance (in Buenos Aires the rate is 0.75% to 2.50% of the transaction)	ITBI is 2.0% in Rio de Janeiro and between 2.0-6.0% in São Paulo; based on gross transfer value of the property; payable by the purchaser	N/A
Provincial real estate tax	0.2-1.5% of the value of the property (land + buildings)	N/A	N/A
Municipal tax	0.57% of the value of the property annually	IPTU is levied at between 0.60 – 2.00$R/usable m^2/month	N/A
Value Added Tax	21.0%, applicable on new and refurbished buildings only	ICMS is 18%	15.0% on purchase price except on sale of land or structures used for residential purposes
Broker's Fee	3.0% to 5.0%	4.0% to 5.0% plus Imposto sobre Serviços (ISS) of 5.0%.	4.0% - 5.0%

* The restricted zone includes all of Baja California and land located within 100 km from Mexico's borders or 50 km from its coastline. Ownership of non-residential real estate within the restricted zone through a foreign-owned Mexican corporation is also allowed, provided that approval is obtained from the Secretaria de Relaciones Exteriores (SRE).

3.6.3 Leasing

The table below represents the standard leasing terms for office space in each market.

	Argentina	**Brazil**	**Mexico**
Type of lease	Net	Net	Net
Term	3 to 5 years	5 years	3 to 5 years
Measurement	Square Meter	Square Meter	Square Meter
Denomination	Argentine Peso	Brazilian Real	Mexican Pesos or US Dollars
Payment Frequency	Monthly in advance	Monthly in advance	Monthly, in advance
Escalation	Rent adjustment every three years	Rent adjustment every three years	Rent adjustment annually according to Indice Nacional de Precios al Consumidor (INPC).
Rent Indexation	Based on US CPI	Annually, based on Índice Geral de Preços do Mercado (IGPM)	Peso-denominated rent annually adjusted by General Rent Price Index; dollar-denominated rent adjusted by US CPI
Early Termination	Allowed after first **six months**, subject to 60 days prior written notice. Penalty is 1½ months rent during the first year or 1 month of rent thereafter	There is no statutory provision on commercial real estate	There is no statutory provision on commercial real estate
Security Deposit	Two months' rent	A renewable letter of credit	Two months' rent
Broker's Fee	3.0% - 5.0%	10 – 12% of first year's rent plus ISS	3.0% - 5.0%

3.6.4 Financing and Secondary Markets

One of the biggest deterrents for foreign investors in the region has been the lack of financing available locally. On the other hand, being a capital constrained market also represents an opportunity for the well-heeled foreign investor. This section outlines the financing options that are currently available in each market, the alternative financing schemes that are used in debt-free markets, and the status of secondary markets in the region.

Private Debt

The debt financing market in Mexico is developing once again. According to Hector Klerian of Jones Lang LaSalle in Mexico City, several lenders were hit hard by the devaluation of the peso in 1995 and many stopped lending in the years that followed. Recently, however, GE Capital, Heller Financial and Scotiabank/Inverlat have been originating loans on commercial real estate with increasing competitiveness.

According to the website of GE Capital Real Estate in Mexico, the typical underwriting terms for office buildings that they offer are as follows:[26]

Collateral:	First mortgages on Class A office buildings located in strong sub-markets. Preferred market is Mexico City, but will consider Guadalajara and Monterrey.
Currency:	US Dollar denominated financing for buildings with US Dollar denominated leases. Some flexibility with buildings containing a mix of Dollar and Peso leases
Loan Size:	US$5,000,000 and up
Rates:	Floating over LIBOR or Fixed over US Treasury Rates
***Pricing:**	Construction: 500 – 550 bps over LIBOR Permanent: 375 – 425 bps over LIBOR
Commitment Fee:	Up to a 1% fee
Loan-to-Value:	65% to 75%
Amortization:	10 – 15 years
Term:	Typically 5-7 years**
Pre-Payment / Lock-out:	Flexible terms
Guarantor:	Non-recourse
Due Diligence:	Required are environmental & structural engineering reports, seismic study (where applicable) and cash flow audit

[26] http://www.gecapitalrealestate.com.mx/

*These sample spreads were given in a June 2001 interview with GE Capital in Mexico City. GE indicated that these rates are sometimes lower due to mitigating factors such as high quality sponsorship, collateral, tenancy, etc.

**The most common term/amortization combination is 7/13, though amortization periods can be pushed out as far as 17 years. A credit tenant loan can fully-amortize over a 15-year schedule (depending on the term of the lease).

In Argentina and Brazil, long-term debt financing is not a viable option for owners of commercial property. Commercial mortgage loans are typically priced as a spread over a benchmark, such as US Treasuries or LIBOR. In Argentina, the 1 month BAIBOR, the Buenos Aires inter-bank offering rate, has reached 35% in July 2001, reflecting the high perception of risk in this country. In Brazil the intra-bank rate, known as the CDI, averaged 20.5% from 1986 to 2000[27]. This in effect makes real estate debt financing cost prohibitive in Argentina and Brazil.

Self-Financing

In Argentina and Brazil, the lack of debt financing has resulted in practices of "self financing". Examples of self-financing include the pre-selling of offices or apartments. According to Turkie, the buyer of an apartment or office floor will often pay a down payment of around 5% and approximately 50% of the purchase price in monthly installments during construction, with the balance due of completion. The practice reduces the developer's capital needs and, according to Daniel Citron formerly of Brazil Realty and now with Tishman Speyer, the practice is

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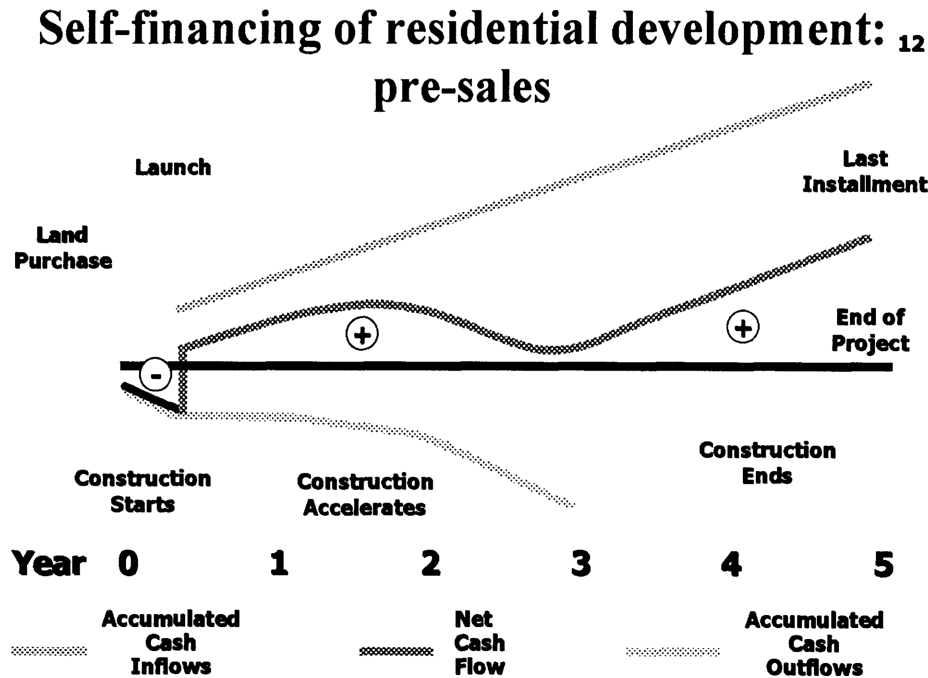
[27] Ministério do Planejamento, Orçamento e Gestão/Brazil Realty

"extremely profitable, when successful."[28] The picture below shows the cash flows of a typical pre-sale scheme for residential development:

Figure 3.9: Self-financing Schemes

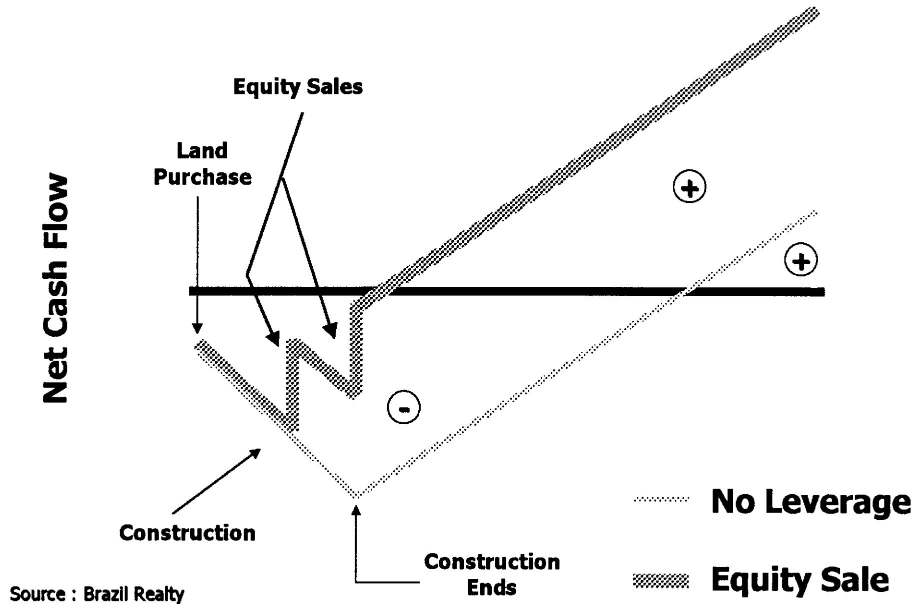


Construction starts once the proceeds from pre-sales have reached approximately 20% of the total development cost (to cover the cost of land and preliminary construction). While the graph shows a simplified accumulated cash inflow stream, the balloon payments at completion and transfer of deed often accelerate the receipt of cash flows. Below is a similar scheme used for the commercial sector, where developers raise capital by selling participations in the project:

[28] Daniel Citron, Brazil Realty Presentation at the Global Property Forum in Washington DC. October 2000

Figure 3.10: Self-financing Schemes (cont.)

Self-financing of commercial development:[13] equity-sales



Public Equity

In addition to the high country risk, the price of debt in these markets is higher than the US due to underdeveloped secondary markets. The lack of secondary trading of debt and equity, like in the US CMBS and REIT markets, effects the availability and pricing of debt and equity.

Fundos de Investimento Imobiliários ("FII") are the Brazilian version of the US Real Estate Investment Trust ("REIT"). FIIs were created in 1993 to provide liquidity to developers and allow small investors to participate in large real estate projects. The FIIs are currently private and closed entities which must be managed by financial institutions that hold the fiduciary

ownership of the fund's assets. The fund's shares are sold through private and/or public placements.

The tax structure of FIIs is similar to that of REITs. In order avoid paying corporate taxes, the fund must distribute at least 95% of net income to its shareholders. Shareholders are taxed 20% upon receipt of dividends and capital gains. An example of a single asset FII offering is the Continental Plaza in Sao Paulo (see Recent Activity section).

According to Citron, the target market of these securities, the general public, will need to be educated and assuaged of their perception of risk. While FIIs are just participations in projects or portfolios as opposed to entities as is the case with REITs, they still have a higher perception of risk compared to direct ownership (see "Cultural Considerations"). In addition, there are legal constraints which must be overcome with the current *Fundos de Investimento Imobiliário* legislation.

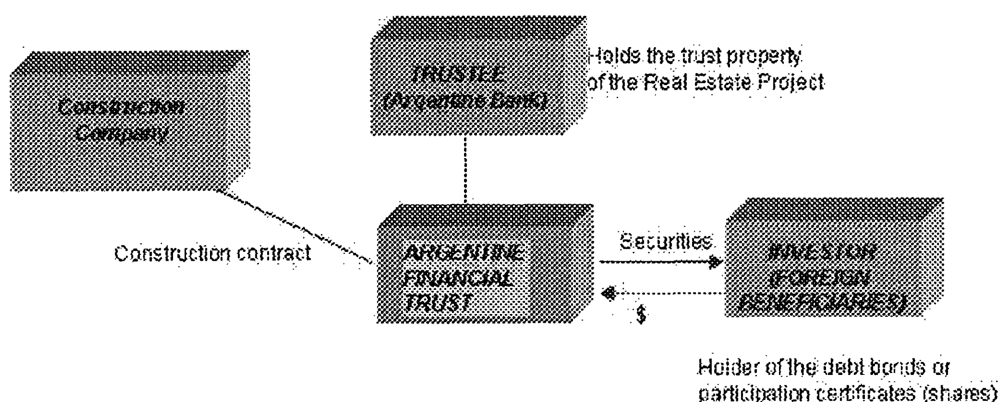
A current controversy with the selling of FIIs is the fear among industry players that they could be used as a method of cheating investors. Some sources indicated that FIIs will often advertise a high, guaranteed introductory return of 12-20%. However, after the introductory period ends in year 2 or 3, the current return will stabilize at a much lower level. While unsophisticated retail investors will buy-in for the high current return, the actual IRR of the investment will turn out to be poor.[29] Others suspect that FIIs could also be a way for Brazilian pension funds to dispose of property without having to recognize large losses (see "Investment Exits" section for background on Brazilian pension funds).

In Argentina and Mexico, the *Fideicomiso* has become a popular ownership structure for foreigners and also as a vehicle for securitizing single assets or portfolios. In Mexico, the structure is similar to trusts set up in the United States, but a Mexican bank must be designated as the trustee and, as such, has title to the property and is the owner of record. The Mexican Government created the *fideicomiso* to reconcile the problems involved in developing the restricted zone and to attract foreign capital. This enabled foreigners, as beneficiaries of the trusts, to "own" land located in the restricted zone without violating the law.

In Argentina, there is a distinction between a *fideicomiso ordinario* (as above) and *fideicomisos financieros*. The financial fideicomisos differ from the *fideicomiso ordinario* in two ways, the first being the existence of a fiduciary and the second being the existence of shares. These shares can be representative of a fixed-income security (debt) or certificates of participation (equity). This class of fideicomiso allows the access of institutional investors such as pension funds, insurance companies, and open-ended funds. The graphic below depicts the general structure of a typical *fideicomiso*:

[29] June 2001 Interview, Fernando Bergamin, Brazil Realty

Figure 3.11: Fideicomisos



Source: Nicolás Malumián, PricewaterhouseCoopers

<u>Public Debt</u>

The commercial mortgage-backed securities (CMBS) markets in Latin America are not fully developed due primarily to the fact that the primary mortgage markets are too thin and inconsistent. Each country has its own underwriting standards, making pooling across borders very difficult. In addition to reducing inflation, establishing uniform currency policies, and increasing loan production, the capital markets themselves are too shallow to support a robust CMBS market. Despite its infancy, in each country there are a number of groups who are dedicated to developing the secondary mortgage market. Although it is not the focus of this report, residential real estate has been leading the way for securitization of commercial property.

In Argentina the Banco Hipotecario, the country's largest mortgage bank, IRSA and the International Finance Corporation (IFC) created a secondary mortgage bank known as Corporacion Financiera Hipotecaria. The CFH´s goal is the creation and development of a

secondary mortgage market in Argentina, providing market players with access to financial resources at suitable terms and rates for the growth of the primary mortgage market. Since its formation in 1997, the bank has launched four transactions, the last one being BHN IV Mortgage Trust. The offering, which totaled $180 million, was the largest transaction to date and the first to utilize political risk insurance. The top tranche was rated an A-1 by Moody's, nine notches above the "sovereign ceiling" for Argentina at the time.[30]

Brazil has also made several significant steps toward establishing a secondary mortgage market. First, in November 1997, the government passed a law that created a new real estate finance system, *Sistema de Financiamento Imobiliário* (SFI). The law established conditions for securitization and the development of a secondary mortgage market in the country. This legislation was followed in 1998 and 1999 by resolutions that revised the housing finance system, *Sistema Financeiro da Habitação* (SFH), and further defined the legal framework for securitization.[31]

In 1997 Brazil also saw the establishment of its first securitization company known as Companhia Brasileira de Securitização ("CIBRASEC"). CIBRASEC is a private sector entity created to build Brazil's first secondary market for real estate backed securities.[32] Further progress included the creation of *Certificados de Recebíveis Imobiliários* ("CRIs"), a type of security backed by mortgages acquired from financial institutions.

[30] http://www.brokernews.net/News/newsmakers/news02160300.htm
[31] Standard & Poors "Securitization in Latin America 2000"
[32] http://www.cibrasec.com.br/

Brazilian Securities, the mortgage securitization arm of investment bank Ourinvest S.A., was also created with the specific purpose to develop the secondary market for real estate mortgages. Ourinvest also originates mortgages through Brazilian Mortgages Companhia Hipotecária, a partnership between Banco Ourinvest and Fabio Nogueira.[33]

In July 2000, Rio Bravo acquired Finpac Consultoria Financeira Ltda, one of Brazil's top independent real estate structured finance firms[34]. Finpac was renamed Rio Bravo Consultoria Financeira Ltda, which, as one of Brazil's first real estate structured finance firms, is actively securitizing residential receivables through the issuance by its wholly owned affiliate – Rio Bravo Securitizadora S.A.[34]

Other important participants in the Brazilian secondary market include commercial banks such as Unibanco, and Itau. However, economic conditions, lack of investor acceptance, concerns over legal infrastructure and tax constraints are primary barriers to further activity in Brazil's secondary mortgage market.

In Mexico the MBS market is developing, especially with the residential sector. Commercial MBS also is developing with the recent $60 million securitization by J.P Morgan of an office building leased to PricewaterhouseCoopers in Mexico City.[35]

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[33] http://www.brazilianmortgages.com.br/; June 2001 interview with Fabio Nogueira
[34] http://www.riobravo.com.br; June 2001 interview with Eduardo Machado
[35] Moody's Investor Service

4 *FOREIGN INVESTMENT IN LATIN AMERICAN REAL ESTATE*

This chapter first reviews some of the current thinking on international real estate investment, specifically the question of quantifying the "foreign risk premium". Then the discussion is related to Latin America by outlining the specific risks for the foreign investor in the region as well as the strategies for mitigating them. After surveying the risks, the investor's opportunities are presented as well as the "exit" strategies that are available in the present and future.

When discussing international investment in real estate there are generally two perspectives to consider. The first is that of the passive risk manager. The main motivation for this investor to venture abroad is the benefit of diversification. The second perspective on international investing is that of the opportunist: an investor who seeks to achieve superior returns by exploiting market inefficiencies.

Professor Timothy Riddiough is doubtful that institutional investors are "fleet enough of foot to achieve superior risk-adjusted returns abroad." However, he does believe that diversification benefits can be derived from international investment. Riddiough cites a study by GPR that looked at returns and volatility of country specific, publicly traded real estate firms.[36] The results showed that "systematic risk at both the country and global levels often matters, that there is a significant amount of variation in the estimated relations across countries, and that there is a significant amount of idiosyncratic risk is most cases." The existence of country specific factors and idiosyncratic risk would suggest that they could at least be partially diversified away by investing in multiple countries.

The diversification argument also works due to the low correlation between some of these countries. Most countries' real estate markets are more heterogeneous than the relatively diverse United States. This, combined with the low correlation, suggests that diversification benefits can be derived from investing in foreign real estate.

Despite the fact that diversification may be the strongest argument for investment in foreign real estate, opportunity was also strong force in attracting the current foreign investment players to Latin America. Some groups have raised funds specifically targeting the region, such as JP Morgan/Peabody with their Argo 1 & 2 funds. It can be assumed that the clients of these funds, institutions and/or private investors, are not allocating 100% of their resources to this region, so diversification is a factor as well. On the other hand, the opportunity of getting higher returns than in the US or Europe is also a reason why they're there. In other words, both the appetite for higher returns and for greater diversification play a role in the decision to enter these markets.

4.1 The Foreign Risk Premium

The decision of whether or not to invest in Latin America, from an opportunistic or portfolio perspective, usually begins with an assessment of the excess return required to make up for the additional risk assumed. This section summarizes the "hurdle rate" analysis of different companies who are active in international real estate investment.

According to Ric Lewis of Curzon Global Partners, due to perhaps a "hangover" from previous failures in foreign markets, many fund managers "have built into their return expectations a specific premium for assuming property-related investment risk outside of their domestic market

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[36] Tim Riddiough, Class Notes 2001, (name specific study)

– a tolling charge they refer to as the 'international risk premium'. This premium is an arbitrary incremental additional return requirement assigned to all investment strategies focused outside of the investor's domestic market."[37]

The argument against this arbitrary premium is that investors cannot expect higher returns simply by investing abroad since foreign capital should not be paid a premium above domestic capital. In the long run this arbitrage could not be sustainable. As Lewis states, "an investor cannot secure arbitrary premiums for subjective rather than market-based factors".

To qualify this argument, Prudential Real Estate Investors points out that the myth of the foreign risk premium is most vivid in cross-border investments between two core markets, such as the US and Japan. In the long run, country risks of core countries tend to converge. For example, today Japan is perceived in the short run to be riskier than the United States, while 10 years ago this perception was reversed. "Hence, for investors placing capital from one core market to another core market, the foreign risk premium is more myth than reality."[38]

Nonetheless, in emerging markets such as Latin America the risks are often times much greater than in core markets. The investor in this region should require a higher return to match the higher assumed risk. However, if the risk is priced correctly, the "risk-adjusted" return for investing in emerging markets should equal that of a core market in the long run.

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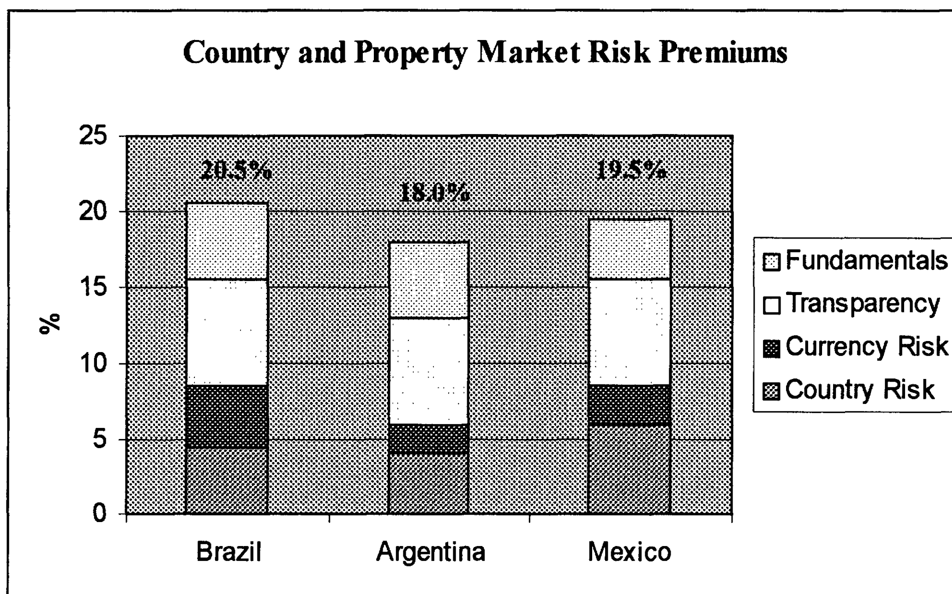
[37] Ric Lewis, Curzon Global Partners, "Global Diversification of Real Estate Portfolios: At What Price Fear"
[38] Prudential Real Estate Investors, "Myths and Realities of International Real Estate Investing", Nov '99

4.1.1 Categorization approach

For all potential investors there are two main approaches to estimating the "hurdle rate" required for investing abroad: the categorization-based method and market-based method.

The categorization-based method involves assigning a risk premium to various categories of risk (country, currency, etc.) to build-up an overall risk premium over their own risk-free rate. To illustrate, a US investor assessing an investment in Brazil should add a 20.5% premium above the US risk-free rate of 6%, an example given in LaSalle Investment Management's Investment Strategy Annual Report:[39]

Figure 4.1: Risk Premiums



Source: LaSalle Investment Management, "Investment Strategy Annual" 2000

[39] LaSalle Investment Management, "Investment Strategy Annual Report", 2000

According to LaSalle IM, this practice "reminds investors to be conscious of all the various types of risk that they encounter when they leave their home countries." LaSalle also points out that country risk, although often being the largest component of emerging market risk, is only one component of the hurdle rate. For example, "a hurdle rate of more than 25% is appropriate when evaluating very safe investments in a risky market, but is also may be appropriate to seek that same rate of return on riskier investments in a much more stable market."

According to LaSalle, the main components for building the international risk premiums are:

- Country Risk
- Currency Risk
- Property Market Transparency
- Property Market Fundamentals
- Operations
- Leverage
- Ownership/Management Structure

There are a few drawbacks to the categorization-based approach. Quantifying each component is challenging and subjective. Some of the components, such as country risk and currency, could be related to one another and thus double-counted in the hurdle rate. The issue of time also adds difficulty to this analysis. Many of these risk components are not static, as represented by this snapshot approach, but rather are dynamic and more difficult to quantify. For example, as shown

in Figure 4.1, an investor would have favored a deal in Argentina over a similar transaction in Mexico (probably quite the opposite today).

4.1.2 Market approach

The market-based method uses statistical evidence from publicly traded securities and country credit ratings to calculate an overall risk premium. Prudential Real Estate Investors developed a country risk premium based on country stock market returns and country credit ratings from the journal Institutional Investor. PREI's model only addresses country risk, not real estate specific risks such as transparency or liquidity. But PREI argues that country risk should already capture a significant portion of the real estate-specific risks.

This model was estimated in February 2000 using country market returns and credit ratings from Institutional Investor. Based on the data set, the equation was estimated to be[40]:

$$R_i = 30.78 - 5.43 * Ln(C_i)$$

Table 4.1 shows the results of PREI's February 2000 study as well as the figures updated as of March 2001:

[40] The relationship between expected return and country risk is a log-linear function based on a Erb, Harvey and Viskanta study entitled "Expected Returns and Volatilities in 135 Countries."

Table 4.1: Country Risk Premiums

	Feb 2000 Credit Score	Expected Return	March 2001 Credit Score	Expected Return
Argentina	42.4	21.0%	39.8	21.9%
Brazil	36.5	22.8%	43.7	20.8%
Mexico	48.2	19.4%	57.3	17.6%
United States	90.9	12.0%	92.7	12.0%

Source: Youguo Liang & Willard McIntosh, "Country Risk Premiums for International Investing" January 2000 Prudential Real Estate Investors; Institutional Investor March 2001 Credit Ratings.

Using the same formula and Institutional Investor's updated credit scores from March 2001, the changes in expected return reflect recent instability in Argentina as well as improved investment climates in Brazil and Mexico.

The market-based approach seems to be a less subjective attempt at quantifying the foreign risk premium. However, as PREI points out, "implicit in the market approach is the assumption that markets can correctly price country risks over the long term." Both the categorization-based method and the market-based approach are susceptible to changes in the future.

As Lewis states, the arbitrary international risk premium should "inevitably decrease to nearer its long-term appropriate resting place – at zero." While this is the case for investment between core countries, the reality is that several of the groups that are currently targeting Latin America are seeking higher returns on both an absolute level and a "risk-adjusted" level. Whether there

exists an upswing in the real estate cycle or a lack of capital available locally, the foreign investor in these markets is often lured by the opportunity to earn a return that is more than ample for the risk assumed.

4.2 Risks for the Foreign Investor

Drilling a bit deeper into the risks that foreign investors build into their hurdle rates for each country, the following are the components of risk that are specific to this region. As previously mentioned, each country's risk profile is different, however, some of these risks are evident in all three markets. One distinction that should be made when discussing risk in this region is the difference between real and perceived risk. While the novice investor perceives a great many risks in this region, upon further analysis some of them are more real than others.

4.2.1 Property Market Transparency

One of the most striking differences between most of these markets and those in the US is the lack of "transparency". This refers to the quantity, quality and reliability of information made available to participants in the marketplace. While perhaps this is due to the small size of these markets or relative unsophistication, most of the principal markets in this region are perceived to be quite opaque.

According to Jones Lang LaSalle's Transparency Ranking, there are five principal criteria of transparent markets:[39]

1. Presence of public and private performance indices
2. Quality of market fundamentals research

3. Availability of reliable financial statements
4. Alignment of interest between directors, managers and investors/shareholders
5. Taxes, penalties, restrictions on cross-boarder transactions.

JLL, in their Investment Strategy Annual 2001, places Argentina in the 5th tier for "opaque" and Brazil and Mexico in the 4th tier for "low transparency". Examples of tier 4 countries are Poland, China and Italy. Tier 5 countries include Turkey, Greece and Chile.

Increasingly, international real estate brokerage and advisory companies are opening operations in Latin America. With the addition of firms such as Cushman and Wakefield, CB Richard Ellis, Colliers and Jones Lang LaSalle, periodic market reports are becoming available with information on asking rents, vacancies and in some cases sale prices. However, due to the small, fragmented markets, this information is still not as reliable as in markets such as the US and Europe.

4.2.2 Real Estate Market Risk

An obvious factor for the foreign investor is the fundamental market risk. The discussion of this risk can be broken down into two components: supply and demand.

On the supply side, with vacancy levels rising and an existing pipeline of development in place, the obvious risk is an oversupply of space. For example, in Mexico City the office market is

17.4% vacant as of 1st quarter 2001, while reportedly there is 309,154 SM under construction, representing 9% of the total market (3.4 million SM).[41]

On the demand side, real estate in Latin America is severely affected by general economic recessions in each country. These economies endured limited recessions in 1998 and 1999 partly due to the Asian Crisis and the Brazilian devaluation. 1999 was a difficult year for the office markets. The devaluation in Brazil significantly affected foreign investors' returns in Rio de Janeiro and Sao Paulo. In Buenos Aires and Santiago office rents declined and will possibly continue to do so in 2002, according to CB Richard Ellis' Market Index report, 1st quarter 2001.[25]

One positive feature that could mitigate the risk of oversupply is that property cycles in emerging markets are likely to be shorter than those in developed markets if these markets continue their high economic growth. According to a report by Torto-Wheaton Research, "demographic patterns in Latin America suggest that the region must invest more in housing and other real estate infrastructure simply to support a population that is growing faster than any other region in the world".[42]

4.2.3 Financing Risk

Financing risk is a large obstacle for foreign investors in the region. Currently, affordable debt financing is virtually non-existent for commercial projects in Argentina and Brazil. In Mexico, debt financing is available with increasing competitiveness. (See "Financing and Secondary Markets" section above for further details of financing options in the region).

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[41] CB Richard Ellis, Indice de Mercado, Mexico DF, 1° Trimestre 2001
[42] Torto Wheaton Research, Growth Opportunities in Latin America, June 7 2000

4.2.4 Ownership Structure Risk

Land ownership is extremely fractured in most urban areas in Latin America. Assembling large sites to accommodate a modern office tower often requires years of land assembly.[43] The result is that there has been a consistent under supply of quality office space. As a counter result, many cities have expanded into satellite centers (such as Sao Paulo and Mexico DF) if not constrained by extreme centralization (such as Buenos Aires) or by natural conditions (i.e. Rio de Janeiro). So, there are both risks of a lack of urban parcels and of the creation of alternative sub centers.

In addition to land, ownership of properties is also fragmented. Christopher Penn of Jones Lang LaSalle in Brazil estimated that "at least 50% of downtown Sao Paulo is in stratified ownership".44 Developments have been financed by selling one floor at a time to investors. The end result is a building owned by multiple tenants, making retrofits or major capital refurbishments nearly impossible. This process has in the past created huge losses for the government in terms of the inefficiency of planning and installing a complete network of services (transportation, drainage, power and water lines) in areas that only a few decades later are abandoned by the best class office users. Sao Paulo's downtown clearly exemplifies this.

While selling floors, flats, or rooms is currently a lucrative exit for developers, it also makes acquisition of existing assets a near impossible task to accomplish. The investor must aggregate all fractions of the building and, as in the case with amassing parcels of land for development, the investor is susceptible to being "held up" by the last owner.

[43] Jones Lang Lasalle, Prospectus of Torre Norte, November 2000
[44] Christopher Penn, Jones Lang Lasalle, June 2001 interview

4.2.5 Leasing Risk

In Latin America the leasing risk varies from market to market (see Market Comparisons: Leasing for details on leasing standards). In Argentina, lease laws govern the relationship between the tenant and owner, as opposed to the "contract being king" like in the US. As discussed in the previous chapter, the *Ley de Alquileres* represents a potentially great risk for owners and investors.

The most commonly given counter-argument to the risk of early lease termination is that since tenants pay all of the tenant improvements (TIs), they are less likely to cancel their leases. The smaller the office space or level of TI required, the higher the probability of cancellation. Additionally, as one player in the market noted, when tenants want out of a lease they can usually find a way, even without this law.

Local sentiments on this law are somehow ambivalent. On one hand both local developers and established international groups feel comfortable with this law. They know that they are protected both on their leases, due to the high expenses of the TIs, and on their market share. In fact, the argument can be made that they benefit from the fact that potential outside competitors perceive the law as a greater risk than it really is.

However, as Francis Pons from CB Richard Ellis pointed out during the latest Americas Point Meeting in Buenos Aires, this law should be abolished to allow a normal functioning of the capital markets in real estate. Leases are not viewed as in the US, where they are often virtually

traded as bonds in secondary markets. In Latin America when primary and secondary debt markets emerge surely one of the first things lenders will request is to modify Article 8." Furthermore, Pons said that the law is better justified for protecting residential tenants, rather than commercial giants such as General Motors or Shell.[45]

An additional risk is that lease terms are in general much shorter than in US. In Buenos Aires, typically for multinational companies, leases for Class A office space are 3 to 5 years in length. The more standardized the space, the shorter the lease period. In Brazil, office space is on average leased around periods of 5 years. Even in Mexico, the "credit" deals in industrial sector are not 20-year leases like in the US. Generally 10 years is the longest term, with average leases at 3-7 years.

4.2.6 Political Risk

In addition to speculative and business risks, political risk is also a major source of concern for investors. Traditional discussions of political risk in this region were usually related to the very real threat of expropriation by military governments or civil hostility and strife. While social unrest is still an issue today due to high levels of unemployment, the political risks that have the most impact on real estate investment tend to relate to legislation and policy.

Given its immobility, real estate is most vulnerable to government expropriation, excessive taxes or even arbitrary decisions affecting the future development of space. As a result, real estate assets with significant exposures to these risks should carry appropriate risk premiums. For example, recently in Mexico DF the newly elected mayor Mr. Lopez Obrador has unilaterally

[45] Francis Pons, CB Richard Ellis, presentation at Americas Meeting Point, Buenos Aires, June 2001

halted further development of office space in the submarket of Santa Fe.[46] Usually these measures are reversed after long periods of concealed negotiations, however they only serve to exacerbate the sentiment of a lack of transparency of these markets.

Another example of the unpredictability of legislation is in this region is the case of Argentina's value added tax (VAT). Historically this tax (21% of net profits less the deductible base) was recoverable on the first sale of the property. It was excluded from both the land value and the labor costs, bringing down the overall cost to approximately 16% of the total development cost. This cost was offset with the sales VAT in the first title transfer. In the event that the building is lined up for rent, this cost historically became part of the total cost because it could not be passed on to the building's tenants. Only recently has the government decided to allow owners to pass this cost on to rent. As a result, tenants are obliged to pay back the developer the 21% VAT tax. While the ultimate impact of this measure is still not clear, it is an example of the today's type of political risk in the region.

4.2.7 Currency

The risk of currency devaluation is a threat to the stability of dollar denominated returns. All of these markets have had a history of volatile currencies. Although in Argentina and Mexico rents can be dollars, in view of the policy changes in these markets, devaluation is always a risk. Real estate remains linked to the overall economic situation. As one international real estate investor says, "you make carton boxes because somebody makes shoes" and not the other way round.[47] In Brazil this case is evident, which had the following recipe for disaster: dollar denominated

[46] Ricardo Zuniga, Hines, Mexico DF, June 2001 interview
[47] Lorenz Reibling, Taurus Investment Group, August 2001 interview

foreigners made investments in real estate, with leases in Reais which devaluated severely in 1999.

The chart below exemplifies the consequence of such changes in the short-term horizon (i.e. a 1 year outlook).[48]

Figure 4.2: Effects of Devaluation: Nominal and Real

(Jan. '99 to June '00)	Rent Transactions R$ per SM			Rent Transactions US$ per SM		
Property	Jan 99	Jun 00	Nominal Growth	Jan 99	Jun 00	Real Loss in US$
Cenu Norte, Sao Paulo	50.00	67.80	35.60%	41.32	37.05	-11.05%
Birman 11 &12, Sao Paulo	27.79	38.09	37.06%	22.97	20.81	-10.34%
Caemi,Rio de Janeiro	47.00	65.00	38.30%	38.84	35.53	-9.36%
Mourisco, Rio de Janeiro	47.00	65.00	38.30%	38.84	35.52	-9.36%
	Ave. Nominal Growth: 37.31%			Ave. Real Loss in US$: -10.15%		

Source: Javier Marquina, CB Richard Ellis, 2000

While currency devaluation was 35% between January 1999 and June 2000, the loss in US dollars was only 10.15%, due to a combination of real rental growth and indexation of rents to inflation (the GPI Index of Inflation was 21.2% for the same period). The view among the foreign players who have stayed in Brazil is that sooner or later inflation catches up with devaluation and investments recover. Nonetheless, for the short-horizon investor currency represents a major risk.

4.3 Strategies for Minimizing Risk

While there are many risks involved with an investment in this region, there are also a number of mitigants for them. Historically, the options for mitigating risk in international investments have included insurance from providers such as the Overseas Private Investment Corporation (OPIC). This section presents a few of the strategies that investors in Latin American real estate employ today:

4.3.1 Currency Hedging

Every foreign investor in these markets would like to neutralize exposure to currency movements, especially the more risk-averse institution such as an insurance company or pension fund. As noted above, the net return of a seemingly profitable real estate investment abroad can be much lower or even negative when the effects of currency movements are factored in. In theory, if the cash flows can be predicted accurately, hedging can effectively neutralize one's exposure to currency fluctuations, net of transaction costs. The problem with derivatives, however, is that there must be someone willing to take the other side of the bet. Currently in Latin America (Argentina in particular), no one is willing make the market without a fee that kills even the most lucrative deal.

The strategies for hedging currency risk typically involve one or more of the following options (with definitions by JP Morgan Treasury Services[49]):

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[48] Javier Marquina, Global Property Forum 2000, Washington DC

[49] Andrew Best, "Hedging Asian Currency Risk" http://www.gtnews.com/articles2/1610.html

Outright currency forwards – Outright forwards are an agreement to exchange a specified amount of one currency for another at a future date at a certain rate. The exchange of currencies is priced to allow no risk-free arbitrage. Pricing is not a market estimate of the spot rate at that date, but is made according to the two currencies' respective interest rates.

Currency swaps – Currency swaps involve the exchange of cash flows in one currency for those in another. Cross-currency swaps often require an exchange of principal. The notional principal may be exchanged at inception at the prevailing spot rate. Interest rate payments are swapped on a fixed and/or floating basis. The principal is re-exchanged at maturity at the initial spot rate. This re-exchange may enable hedgers to avoid translation losses, and show some translation gains, if the exchange rate they are hedging weakens from the spot rate at which they hedge.

Principal-only swaps – A principal-only swap is a transaction designed to hedge the FX exposure arising from foreign currency borrowings. It differs from a currency swap in that it hedges the principal exposure only, and not the interim interest payments.

According to Johnson, Worzala, Lizieri and Kinnard, applying the above techniques is difficult because "unlike bonds and equity markets, the market for real estate is illiquid and is subject to high transaction, information and management costs."[50] They also add that the longer holding period adds uncertainly to cash flows, including the sale value, and makes exchange rates harder to forecast. Also, the costs for hedging using traditional techniques are much greater since they

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[50] Richard Johnson, Elaine Worzala, Colin Lizieri, William Kinnard, "Mitigating Currency Risk for International Hotel Investments: Can It Be Done?" Institutional Investor, Summer 2001

are generally meant for short terms. It seems that investors have yet to find an even reasonable insurance against devaluation in this region, let alone a "perfect hedge".

According to Francisco Bosch of the Peabody Group in Buenos Aires, "hedging does not exist today. In the past you could do it at (a cost of) 3-10% per year, which was always cost prohibitive. Alternatives to hedging are to level up in local money, structure rents in dollars, if you can, or include escalations to make up for devaluation of the currency."[51]

Bosch indicated that the cost of hedging was prohibitive in Brazil as well. Developers can, however, index sale contracts to IGPM (Brazilian inflation) on a monthly basis (typically the government only allows annual indexation). According to Luke Toft of Cargill in Sao Paulo, "the theory is that inflation and devaluation should be the same - the longer the horizon the closer the correlation between IGPM and devaluation. Since real estate projects have 3-5 year horizons, a medium term, the hedge works - although it's not perfect."

It seems that IGPM would provide at least a partial hedge. However, as Toft points out, "if you look at the last 12 months, devaluation has been 35% and IGPM has been 10% - over this short period the hedge clearly has not worked. On the other hand, inflation is picking up and the Real volatility has been heavily influenced by external factors. We would bet that the 25% spread shrinks considerably over the next 12 months."

Prudential Real Estate Investors offers a somewhat comforting counter to the problem of currency hedging. While the long-term holding period creates problems for hedging, it also

lessens the effects of currency on the investment's returns. "The long-term volatility is most relevant to the performance of real estate investments, and...currency effects rarely affect investment performance over 8 year or longer periods of time."[38] PREI acknowledges that currency can have great short-term effects, but in the long run they "may only translate into marginally higher long-term volatility for the portfolio and particularly for real estate investments."

4.3.2 Joint Venturing and Entity Level Investment

Many foreign investors try to mitigate risk by partnering up with local real estate companies. The rationale is the same as in the domestic model. Joint ventures are used extensively in real estate "due to the matching benefits of capital, expertise and risk."[52] Investors gain knowledge and expertise from their local partners about the markets, processes, and laws. Local partners are also a source of contacts and deals. Additionally, as many investors point out, these markets are currently just thin to justify operating on a deal-by-deal basis. Investors need consistent deal flow, hence the necessity to work with local groups.

Examples of joint venturing in Latin America range from traditional JVs like the case of Peabody/G.Accion, AIG/Finsa, and Tishman/Metodo, to acquisitions of local companies like Prudential/Icatu and Equity International/FVI. (see Recent Activity section).

In any partnership there is potential for conflicts of interest. For the construction of Torre Norte in Sao Paulo, Tishman Speyer entered into a joint venture with the Brazilian construction

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[51] Francisco Bosch of JP Morgan/Peabody Group, June 2001 interview
[52] David Marks, The Blackstone Group, Auguest 2001 interview

company, Método Engenharia S.A. The venture was publicized as a "strategic alliance" that combined TSP's world-class development capabilities with Método's construction expertise and familiarity with the market. The JV was a success in providing Tishman with local market knowledge, but one could question the strategy given the conflicts of interest that are inherent between builders and developers. The best international partnership probably is not necessarily with a contractor or developer but rather one that brings both capital and local connections, yet doesn't assume an inordinate amount of control.

This ideal of a local partner is hard to come by. As Rick Koenigsberger from Apollo Real Estate Advisors puts it, "in Latin America the local groups that want you are often times the ones to stay away from, while the ones you'd like to partner up with don't need you."[53]

Co-investment, while required by most capital partners in order to insure alignment of interests, is not always feasible for the local partner. Cargill, for instance, originally partnered up with RED, a very knowledgeable local consultant in Buenos Aires headed by Marcelo Alexander. However, mostly due to large co-investment requirements, RED is no longer a JV partner of Cargill and is currently focusing on advisory.

According to Bosch, when it comes to the issue of managing risk in this market, "players need to accept that they're in an emerging market. If you start an investment memo by having to sell your investors on Brazil, for example, then you won't get any deals done here."[51]

[53] Rick Koenigsberger, Apollo Real Estate Advisors, July 2001 interview

4.4 Investment Strategies and Recent Activity

This section first categorizes the main investment strategies that foreign investors are using in the region. Within each category, examples of recent investment by the most prominent foreign groups in the region are presented as well.

4.4.1 Investment Strategies

Latin America is considered a highly volatile emerging market. The situation in Argentina, plus experiences with the Mexican and Brazilian devaluations still keep away the majority of international real estate investment players. Particularly, the region is currently shunned by all but a few of the better-known high yield funds. Several opportunistic investors, such as Apollo Real Estate Advisors, Blackstone, and Soros Real Estate Investors, have recently raised funds focused almost exclusively on Europe and Asia.

The foreign investment groups that are currently in the region are generally looking only at the major metropolitan areas of Mexico, Brazil, Chile and Argentina. Second-tier markets, which have attracted some additional interest, include Venezuela, Peru and Costa Rica.

Building Platforms

Foreign investors are looking for investment opportunities in the region, with their focus varying from direct acquisition of individual assets to joint ventures with regional players to participation or take-over of existing companies with an established presence in the entire region. For the latter categories, their investments in the region represent a vehicle for creating a regional

operation or platform. The motivations for building a platform include exploiting regional synergies and facilitating an eventual exit. As discussed further in Map of Investment Exits section, the strategy is to build the regional operation up and make it attractive to potential foreign institutional investors.

A crucial component to building a regional platform that will attract institutional investors is what Roberto Ordorica from Prudential Real Estate Investors (PREI) calls a "champion". Due to the lack of knowledge that the typical American investor has of these markets, there is a need for one person or group to take the flag as the leader into the region. "Edward Siskind (of Goldman Sachs' Whitehall Fund) or Tom McDonald (of Equity International) embody that type of personality."[54]

Also characteristic of the platform model is investment at the entity level as opposed to single-asset acquisitions or development. Both Prudential and Equity International are currently following this model, injecting capital and creating autonomous entities in each country. PREI's operations in Brazil started with the acquisition of Icatu, part of the construction conglomerate of the Braga family in São Paulo. The new company, Prudential-Icatu Gestão De Investimentos Imobiliários, is also forming Atlantica Residential to focus on the middle-income housing market. These groups are participating in companies with local expertise and contacts, and creating their own exit vehicle, either by selling the assets individually, selling the entire company or taking it public through an initial public offering. Already this model was proven successful by investors such as George Soros who participated in IRSA, which was subsequently

[54] Roberto Ordorica, Prudential Real Estate Investors, Parsippany, July 2001,interview

taken public. At a later stage Soros sold part of his participation back to IRSA and another part to JP Morgan/Peabody Fund.

Equity International Properties, Sam Zell's privately held company which invests in real estate companies and properties outside of the United States, is taking this model a step further. As Senior VP Tom McDonald puts it, "we want to be a regional player with a platform that could one day attract a foreign institution that is interested in participating in Latin American real estate as region".[62] Equity first set foot in the region in Argentina in 1997. Equity purchased a 70% interest in Dock del Plata from Comercial del Plata, the remaining 30% belonging to Volkswagen. This investment also helped Equity International learn the rules of the region. Equity International will pursue opportunistic investments along with funds from institutional investors, who will expect 20%-plus leveraged returns. Their exit strategy, according to McDonald, is to sell the assets or take them public within a 3 to 5-year window.[62]

Through the process Equity International came to realize that the same amount of time that would be spent doing "one-off" acquisitions could be spent in purchasing an existing platform. "The brain damage and the amount of micromanagement you are involved in are justifiable only with the larger scale deals" according to McDonald. In December 1999 Equity International entered the hotel market through a joint venture with Spanish operator NH Hoteles. Since the investment, NH has expanded operations to Brazil, Argentina, Mexico, Uruguay and Chile. In July 2001 they have raised their participation in the company from $42.5 M to a $70M to expand the Mexico operation from 1,400 to 2,800 total rooms.

On the same idea Equity International formed Latinoamerican Office Properties (LOP). LOP has started to amass a portfolio of office properties mainly through the partnership with Fondo de Valores Inmobiliarios from Venezuela. Their intention is to build a portfolio through partnerships with operators in Chile, Peru, Costa Rica, Mexico and Brasil. One of the exit strategies is to find an institutional investor interested in buying out a real Latin American office portfolio.

Equity International is also active in the industrial sector concentrating on industrial and Maquiladora markets in Northern Mexico. They invested significant capital in Denver-based Development Company of the Americas to form Corporate Properties of the Americas (CPA). CPA (and the predecessor company) has acquired or developed over one million square feet of industrial property in Mexico since 1997. The portfolio is tenanted by a diverse group of leading multinational companies in markets such as Monterrey, Tijuana and Reynosa. Again the strategy for Equity International is to eventually sell to an American investor or REIT involved in industrial property.

"Exporting Expertise"

Another approach is the one used by international developers such as Hines or Tishman Speyer. These groups strategically target the region and develop mainly on their own using other people's money. Their competitive advantages are their knowledge in the development field and their connections with large multinational tenants looking for class A space in emerging markets.

In their latest investments (Hines' Northpark in Buenos Aires or Tishman's Rochavera in Sao Paulo) these companies are investing equity from their investment funds. While they may or may not have significant equity in these developments themselves, they are typically in these deals for the fees generated by the projects.

In Argentina, after their initial go at the properties of Perez Companc Group, which finally ended up in IRSA's hands, Tishman focused on Puerto Madero for the development of 78,000 SM of Class A office space. According to Julian Villacorta of TSP Brazil, the project, Madero IV, is currently on hold until the parties are able to find long-term financing. Currently they are in talks with main commercial banks in Buenos Aires who are possibly interested in partnering up for the development.

In Brazil, Tishman joint ventured with partner Método Engenharia, a local construction company, to successfully develop Torre Norte. Funcef, the third largest Brazilian pension fund, invested the bulk of the equity required. The project, which introduced new standards in office space, was fully leased by March 2000 and today commands the highest rents in São Paulo for Class A office space. Tishman entered the market with a fee contract and is now a recognized player in the development of important mix use projects. Their second major development will be the conversion of the CIBA site, a few miles down from Torre Norte, into a mixed-use two-phase project totaling nearly 120,000 SM. In this project Tishman will be a direct equity investor through their global investment partner, Travelers Insurance. Tishman has opted to acquire additional local knowledge by bringing to the team Daniel Citron, previous head of Brazil Realty-Cyrela.

The Texas-based developer Hines, through their Emerging Market Fund, started construction of Northpark, the company's first venture into Argentina. The project is a $35 million, 20,000 SM office building outside of Buenos Aires's downtown, which is oriented to those companies intending to stay close to the residential neighborhoods of Buenos Aires and yet well connected through the north access to downtown. They are entering into the market at a time of low expectations, and currently seem to be the only developer going forward with their project.

In Mexico, Hines partnered up with local group Promociones Metrópolis and created Del Bosque, the premier office and residential development in the high-end Polanco district. In the office market Hines developed Torre del Angel, consisting of the purchase of a distressed asset brought through IPAB on a full equity basis. Hines also joined with two Mexican firms to build the $50 million Parque Industrial. Recently the company was able to pull out equity through a financing from GE Capital for nearly 50% of their Mexican portfolio.

In Brazil Hines has been in operation since 1997 following multinational companies as they fled the distressed Russian and Asian markets for new ones like South America. Hines, in a joint venture with Itacesa Emprendimentos, one of Brazil's largest developers, a $70 million speculative office building of 40,000 SM, known as Panamericana Park. In another deal, Dpaschoal, a tire distributor in Brazil, selected Hines to act as developer and manager of a new project in Campinas, an area that has been targeted as the Silicon Valley of southeastern Brazil. Hines developed and completed this project in 2001 and is also involved in numerous international asset management, leasing and advisory assignments. As did Tishman, the

company hired local expertise through Doug Munro as managing director of Hines Brazil, formerly with the São Paulo office of CB Richard Ellis.

Some might argue that the competitive advantage of these strategic players is the expertise that they bring to the market from abroad. The counter argument would be that their true competitive advantage is the capital they bring from abroad as well as their contacts with multi-national tenants. Most likely, however, their contacts with these large tenants may be a result of the expertise that they've shown with their domestic projects, and when these companies decide to move into a new market they simply prefer to work with the same developer. The same might be true with their investors, who are following them abroad as a result of successful investments at home.

Niche Foreign Capital Opportunities

In markets that are capital constrained, many believe that by bringing capital from abroad an investor can attain an arbitrage, or at least a higher risk-adjusted return, than they could at home. This is a selling point for many foreign investors in these markets, including the strategic players above. There are also a number of groups who are investing in the region with their own equity.

The Asset Investment & Finance Group of Cargill, the US-based agricultural company, takes this approach to opportunistically target investments throughout the region. Cargill started this strategy at home in the RTC days in the early 1990s. They have now exported this strategy to foreign market. According to Ariel Turkie in Buenos Aires, Cargill is here simply because

"there are opportunities in these market to buy assets out there that can be repositioned".[55] They are not trying to invent anything new, unlike perhaps the strategic players above. Rather, they believe that their only competitive advantage is the cash that they bring. For example, In Brazil and Argentina, Cargill is mimicking the local real estate games. Their exits are not through the capital markets but through the pockets of the individual investors looking for the certainty of real estate.

Cargill started their operations in Mexico after the financial crisis of 1994, trying to locate portfolios of under-performing loans. They currently operate in Argentina under the name of Andean Asset Management. Cargill already controls nearly $80 million of real estate assets in Argentina. They started in 1997 by acquiring a 5-story property on the edge of the Catalinas district which they repositioned in the market after a complete refurbishment, which included the addition of 5 office floors and a new façade. In 1999 they executed a sale/leaseback with Shell for the acquisition of their headquarters in Buenos Aires.

The ability to finance their acquisitions with a multi-billion dollar balance sheet allowed them to acquire from Birman a plot of land in the high end of Puerto Madero where they have started the construction of the Riverview complex mimicking the success of Argentinean developers creating high quality apartments. The entire development of high-end condominiums is being presold in installments to individual wealthy individuals.

Cargill has opened an office in São Paulo as well where the pool of local capital is seemingly much deeper. They formed a joint venture with Impar, a local construction company, who

[55] Ariel Turkie, Andean Asset Management (Cargill), June 2001 interview

contributed the land to develop the Continental Square in Faria Lima, a mix-use development with 2 hotels and office space totaling 120,000 square meters. Cargill entered the deal as the equity partner. The entire development is being presold through the Fondos do Investimento Imobiliários (see Financing section above) to individual and institutional investors. Another investment is the development of the complex Alto de Boa Vista, a high-end subdivision in the outskirts of São Paulo.

Other Recent Investment

The above categories are not mutually exclusive. In many case, foreign investors operate in the region under a combination of strategies. Listed below are some of these groups.

The insurance giant AIG has partnered up with Finsa as an equity investor and are now co-holders of the biggest industrial portfolio in Latin America with more than 5 million square meters throughout the region. Finsa is operating in 13 cities in México, 1 in Texas y 1 in Argentina. Once again armed with AIG's equity and a fixed line of credit for $250 million from GE Capital, Finsa is looking to increase its presence in the industrial sector. They have an aggressive acquisition plan geared toward adding a total of 7M square meters in the next three years[56].

The Peabody Group, a commingled fund with 10% participation from JP Morgan, 2% from J.W. O'Connor & Co. and 88% from private investors, has originated two capital placements in Latin America through their funds, Argo 1 ($400 million) and Argo 2 ($200 million). Argo 1 was

[56] Karl Trieschman AIG Buenos Aires May 2001

closed with the purchase of 5% of the shares in IRSA from George Soros at approximately $3 per share for a total of $27 million.

IRSA is one of the most important real estate companies in Argentina. The company participates in the acquisition, development and operation of office, retail and hotels and in the development and sale of housing complexes. The company possesses more than 85,000 SM of office space (10% of the total Class A stock in Buenos Aires), 7 shopping centers, 3 hotels and 8.5 SM of land. Additionally it has an international presence through Brazil Realty, a company that started by mimicking the IRSA model in Brazil.

When Peabody made the IRSA investment they saw an opportunity to invest in the leading Argentine real estate company at a discount to their net asset value. Since the purchase, however, IRSA's stock has more than halved. In the year 2000, sales in their shopping center portfolio fell 20% and income through development and sales fell 30%. Another problem looming for IRSA is that 60% of its debt is maturing before March 2002, which could cause considerable distress and further stock price reduction.[57]

The Peabody Group also made direct investments in Plaza Logistica, a 60,000 SM distribution center just outside of Buenos Aires. Peabody has partnered up with two Argentinean groups, Jorge Ader and the Bemberg Group, through their affiliate DASA for this project. Peabody is actively looking into the Brazilian market trying to locate deals mainly through the acquisition of properties that have to be disposed off the balance sheets of local pension funds

Peabody has also invested directly in G. Accion S.A., a Mexican real estate company which focuses on the US dollar-denominated industrial real estate market. According to John Rivard, Principal of the Peabody Group, they have invested nearly $60 million in the company, which holds nearly 4 million square feet of industrial property, the second largest portfolio in Mexico after FINSA. The properties are diversified in Mexico with major concentrations in Juarez, Guadalajuara, Tijuana, and Monterrey and Mexico City. By investing in a smaller company (than IRSA in Argentina) Peabody retained more control, holding nearly 40% of the stock and a seat on the company's Board of Directors.

The region has also seen the presence of the Goldman Sachs's Whitehall Fund. They have participated, under the management of Ed Siskin, in the Mexican hotel market through their acquisition of part of the stock of the Pamia. In Argentina and Brazil, Whitehall has invested in the retail sector through their 6% share in APSA, the shopping center developer, and a 4.4% participation in IRSA and in Multiplan, the largest developer of shopping centers in Brazil.

[57] "El Presente de Irsa no es Color de Rosa", Apertura, June 29, 2001

4.5 Opportunities for the Foreign Investor

While there are several sectors which represent potentially attractive investment opportunities, such as housing or pre-selling of office space via private investors, this section outlines three of the most interesting opportunities that are currently developing in the region.

Distressed Assets and Debt

Generally in this region, the lack of long term debt financing makes it difficult to find distressed assets. Since properties are not marked to market on a regular basis by debt service payments, owners still believe that property values remain constant. The result is large bid/ask spreads and generally thin trading in the market. There are, however, a few opportunities in this category.

El Instituto Para la Protección al Ahorro Bancario (IPAB) was created in the wake of Mexico's mid-1990s Peso debacle to absorb nearly $70 billion in both Mexican bank loans that had gone into default and bank-owned properties. IPAB is currently auctioning these pools of non-performing loans as well as assets.

Several traditional real estate investment companies expressed disinterest in the IPAB portfolios, citing that the assets were mostly not of institutional quality. On the other hand, as Jon Grossman from Archon put it, "in the distressed debt game, there's no such thing as bad portfolios, only bad prices".[58] Some of the groups that have bid on these pools include Brimco (JE Robert & Deutsche Bank), Firstcity (Cargill), Amresco de México, Archon/Goldman Sachs, GE Capital, and Lonestar. On the asset side there have been some important auctions of assets

such as the portfolio of the hotel chain Camino Real, which has recently been awarded to Casa Diaz, through its subsidiary, Turistica Paraiso S.A. de C.V. Hines purchased the original Torre del Angel building through an IPAB auction, refurbished and successfully repositioned it in the market.

Dollarized Markets

For foreign investors that are averse to currency risk, the region does have some sectors that are $-denominated. Perhaps the deepest asset class in the region is currently the industrial sector in Northern Mexico. According to Gabriel Fernandez of AIG Global Investors, the sector is booming in terms of investment thanks to the integration of the Mexican and US economies due to NAFTA. It is one of the few sectors in the region that is experiencing asset trading.

Due to the development of this sector perhaps there are many unexploited complementary functions. According to Antonio Elosua of U-Calli in Monterrey, the areas surrounding regional airports could be ripe for warehouse development. Also, the recent relocation of businesses to the sector has created a demand for other uses, such as offices, executive hotels, and housing.

Along the coast, President Fox has made quite clear his intention to favor the tourism industry in order to attract more foreign investment. The government has started plans through what is called the "Escalera Nautica", a plan to expand up the coast of Baja California.[46]

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[58] Jon Grossman, Archon Group, July 2001 interview

In addition to the demand side there is increasing investor appetite in these sectors. With dollarized leases and the availability of $-denominated debt, investors feel that the relatively moderate returns adequately justify the risks.

Brazilian Pension Fund Assets

Pension fund investment in real estate has been a subject of controversy in Brazil. Pension funds were the main investors in large real estate projects in Brazil during the 1990s. According to Paulo Gomes of Prudential-Icatu, "real estate was often sold to Brazilian institutional investors at high prices and was not expected to perform as well as other portions of the portfolio since fund managers knew that prices were inflated from the beginning. In addition, corruption schemes existed in some pension funds. Bribes were deducted from the purchase price, ultimately hurting the fund's beneficiaries."[59]

According to Gomes, beginning in the late 1990s, regulatory agencies increasingly limited the allocation of real estate in those institution's portfolio and now, in contrast to the "buy" mode of the mid-1990s, pension funds are now involved on selling portions of their real estate portfolios.[59]

Although there is a strong incentive to sell properties, there are still a number of obstacles. First, the illiquidity of real estate is exacerbated in the case of pension funds that only hold large participations. Secondly, the current managers of pension funds would have to mark down the book value of poorly contracted investments and have little motivation to be penalized for past managers' actions.

Regardless of these obstacles, the real estate portfolios of Brazilian pension funds may represent an attractive prospect for foreign investors. Brazil seems to be a market in full expansion. As Francisco Bosch asserted, "for every deal in Argentina, people show you ten in Brazil".[51]

4.6 Investment "Exits"

As shown above, there are a number of attractive opportunities for the investor in this region. However, the question most potential investors ask is not about "entrances" but rather "exits". While investors can get into these deals at very attractive cap rates, the big question is whether they will be able to exit at a lower one. The exits for the foreign investor in this region, in the present and future, can be categorized as follows:

The General Public

The general public currently represents an attractive exit for developers of offices, apartments or hotels. As mentioned in previous sections, the stratified ownership, which characterizes much of the commercial stock in Argentina and Brazil, could be a result of the lack of debt financing that necessitates pre-selling. Perhaps an even stronger force, however, is the cultural attitude toward real estate ownership. While some developers pre-sell out of a lack of other financing alternatives, the practice is favored by even the largest and best-capitalized real estate companies in Argentina and Brazil.

According to Tomás Salles, Director of the Brazilian brokerage firm, Lopes Consultoria de Imóveis, the "retail" market is currently by far the most lucrative exit for a developer in Brazil.

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[59] Paulo Gomes, "Brazilian Pension Funds: Real Estate Investments", MIT 2000

In May 2001, his firm liquidated all 780 units of the Holiday Inn Anhembi in a single day. The "rooms" that are sold are really units of participation. In fact, purchasers of flats or rooms for investment are forbidden by law to occupy them. The selling of rooms is "really just marketing...Latin Americans love (to own) real estate." So, while foreign investors have IRR hurdles of 30%+ to get comfortable, the general public is seen as being content with a return of 1% per month (or 12% annually).

Some market participants feel that this will soon change with the development of capital markets in the region. As owners of real estate are forced to compare monthly net operating income to monthly debt service obligations, real estate prices will become more linked with capital markets. As prices are market-to-market on a more regular basis, the argument is that the spread between the price that the general public and institutional investors' price will compress.

Domestic Pension Funds

In recent years there has not been great demand from domestic pension funds for real estate assets. Only in Brazil have pension funds been big consumers of real estate in the last decade. However, whether due to poor judgment or corrupt practices, many pension funds in Brazil have real estate portfolios with market values that are significantly below book values. Recent legislation has mandated that these pension funds reduce their position in real estate. A likely result is that demand for real estate by pension funds will decrease even further.

However, proponents of securitization in these markets feel that pension funds represent great potential for Latin American real estate. In order to match assets and liabilities in their

portfolios, pension funds could invest in real estate asset-backed securities. For example, Argentine pension funds purchased the majority of the units of participation from the fideicomiso of La Nacion building in Buenos Aires in 1999. According to Adrian Dipliotti of PricewaterhouseCoopers, who advised on the transaction, noted that there has been much interest from pension funds for similar asset-backed commercial papers.[60]

Foreign Opportunists

The competitive landscape for opportunistic investors in this region currently varies from fund-oriented groups, such as the Peabody Group or Equity International, to companies operating off of large balance sheets such as Cargill (see Recent Activity section).

These groups, while opportunistically investing in deals themselves, do not represent an attractive exit for investors. In order for these funds to venture into volatile markets such as these, they're return expectations most likely start in the low 20's (percent).

While some of these groups could be considered "opportunity funds", the most familiar names associated with that label, such as Soros, Blackstone, Whitehall or Apollo, are currently staying clear of the region and are focusing on Europe and Asia. According to Rick Koenigsberger of Apollo Real Estate Advisors, opportunity funds are "looking for IRRs that start with a 3".[53] Without underwriting a very aggressive residual value, the way to boost returns to the 30% range is to find cheap local leverage. Although absent in Argentina and Brazil, the debt market has returned to Mexico. But even the existence of affordable debt and dollar-denominated leases has yet to lure the opportunity funds to the country, including the active northern industrial sector.

[60] Adrian Dipliotti, PricewaterhouseCooper, June 2001 interview

According to Renaud Haberkorn of Soros Real Estate Investors, "Mexico's industrial real estate is probably very correlated with the strength and the recovery of the US economy which we don't believe into for the near term."[61]

Foreign Pension Funds & Money Managers

The majority of US pension funds and money managers have yet to enter the Latin American real estate market. The perception of risk, in terms of political, currency, or property market transparency, has been too great for risk-averse fiduciaries. In addition to economic and political conditions keeping them away, institutions which are not taxed at home currently have to pay taxes in Argentina and Brazil.

This is not to say that these groups are ignored altogether by the active players in the region. The current wave of investors is optimistic that things will change. If Mexico can continue its recent strength, and Argentina and Brazil can recover, foreign institutional capital will come. The current strategies seem to be more about "first mover" advantage - building portfolios in anticipation of this eventual stabilization.

According to some in the market, there has been more interest from European pension funds than US ones. For German funds, such as Despa, yields in Latin America are very attractive. For Spanish institutions, there are a number of cultural synergies. According to McDonald of Equity International, "Spanish investors are less averse to the wild cycles of Latin America than their US counterparts."[62] Julian Villacorta from Tishman Brazil repeated the same sentiment, adding

[61] Renaud Haberkorn, Soros Real Estate Investors, July 2001
[62] Tom McDonald, Equity International, July 2001 interview

that for the foreign investor there is an "education process involved, and it is different for EU and US investors. Maybe the Germans and Spaniards will lead the way for the US investors."[63]

A leap of faith

Opportunistic investors seek out capital constrained markets where their cash has a competitive advantage. But an illiquidity play will only pay off if capital subsequently returns to the market, especially important for fund-oriented, time-sensitive investors. The big bet that current foreign players are making is that these countries will improve and real estate will become attractive to the broader foreign investor.

[63] Julian Villacorta, TishmanSpeyer/Metodo, June 2001 interview

5 *CONCLUSION*

Latin America represents a huge source of potential for foreign investors. The region has at times seen large inflows of foreign investment and GDP growth. An especially powerful influence has been the integration with US, especially in Mexico with NAFTA and the potential of treaties integrating Chile, Brazil and possibly Argentina. The region's demographics, with a young population, point to tremendous growth potential as well.

On other hand the region is no stranger to economic crises, with Mexico, Brazil and perhaps currently Argentina, suffering similar problems in recent years. There is a seemingly ever-present risk of default or currency devaluation in the eyes of the foreign investor. All of these economies have passed through previous periods of high inflation and general economic uncertainty.

While the risks are many for an investor, the region offers returns that are attractive. However, in order for foreign investment to stay, these markets must be able to stabilize their economies, offer affordable long-term debt financing, develop their secondary markets, and assuage foreign investors of the lack of transparency.

There are many common themes in the region, however each market also has unique characteristics with unique risk/return profiles. Mexico is currently the safest bet with a booming industrial sector, availability of debt financing, and growing political stability. Brazil may also be poised for tremendous growth, but is still grappling with inflation and currency

devaluation. Argentina's outlook is uncertain. While there is still a deep and highly educated base, the economic recession, high level of unemployment and inefficient political leadership have cast doubts over the country's future.

The advantage of foreign investors is their ability to introduce liquidity to this capital constrained region. The opportunity for these investors is to establish platforms in these markets before economic maturity, foreign institutional appetite and asset market liquidity arrive. According to Sam Zell of Equity International, "just like real estate is all about supply and demand, that applies to real estate capital just as well. (Latin America) is capital short. And, therefore, in that part of the world today, you can do transactions and you can get returns, and you can mollify your risk to produce really positive results. Why? Cause they need us."[64]

[64] Ernst & Young, "Transact '99: Where's The Smart Money Going Next?"

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Milton Chacon, Moody's Investor Service
Mia Koo, Fitch IBCA
David Martinez, Starwood Hotels
Liza Him, CB Richard Ellis
Gabriel Fernandez, AIG Global Real Estate
Jon Turner, Regus
Jonathan Langer, Goldman Sachs/Whitehall Fund
Ken Moskow, American Venture Corp
Lorenz Reibling, Taurus Investment Group
Renaud Haberkorn, Soros Real Estate Investors
Tom McDonald, Equity International
Roberto Ordorica, PREI
Mike Carp, GIC Real Estate
John Rivard, Peabody Group
Thomas Farrell, TishmanSpeyer
Rick Koenigsberger, Apollo Real Estate Advisors