

Research

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The Mexican housing sector is currently one of the country's most dynamic, as its growth far outpaces that of the rest of the economy. Demand for housing in Mexico remains strong, which is no surprise in a nation with historically high population growth. Noteworthy are the supply forces that are propelling market participants toward a comprehensive rearrangement of the sector.

From a housing sector standpoint, Mexico today is in a unique position compared with other populous countries. The number of new households needing homes will remain solid for decades. But in addition to strong demand, Mexico's economy is increasingly prepared to support the need for more and better housing. Since 2000, the country has been rated investment grade, setting a more favorable threshold for returns on Mexican assets. Lower interest rates have translated into much-needed incentives for corporate investment and consumer spending. In turn, Mexico's capital markets are quietly broadening the housing sector's possible sources of capital. For the first time, local pension funds and foreign institutional investors are helping to develop a well-functioning and liquid mortgage-backed securities (MBS) market.

Given that most of the changes moving Mexico's housing industry are fairly new, we have evaluated the evolution of the sector, drawn on the experiences of more developed markets, and studied the effects that comparable behavioral, economic and structural patterns may have on the Mexican market. Thus, we have identified 10 trends that will help to shape the future of Mexican housing and have assessed their impact on investment in the sector. The trends likely to influence the sector are:

1. Demographic forces supporting demand
2. Expansion of the homebuyer base
3. Growth of homebuilders
4. Larger companies going public
5. Stronger institutional framework
6. Greater information sharing
7. Specialization of financial intermediaries
8. Financing for the middle class
9. Diversified pool of funds
10. Mortgage securitization

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These 10 trends support a long-term bet on Mexican housing from four different perspectives: demand, supply, the institutional framework and financing. Independently, each of the trends is expected to have far-reaching consequences on the Mexican housing market; woven together, however, the trends can prove useful as a means to develop specific investment strategies.

Housing Demand: Historically Strong

After several decades of rapid population growth, the growth rate of Mexico’s population has slowed considerably, falling from a peak of 3.6% per year in the 1970s to an estimated present rate of 1.4% per year (see **Exhibit 1**). The expansion rate is forecast to continue to decline over the next decades. Nevertheless, by 2030 Mexico’s population is estimated to reach almost 140 million, about double the 1980 population. Today, Mexico ranks 11th among the world’s most populous countries, with a current population of more than 100 million.

Exhibit 1: Changing Profile of the Mexican Population

Year	Total Population	Annual Growth Rate in Previous Decade	Median Age
1970	48.2	3.3%	16.8
1980	68.7	3.6%	17.6
1990	84.4	2.1%	19.0
2000	100.3	1.7%	22.8
2010E	115.0	1.4%	26.3
2020E	128.0	1.1%	29.9
2030E	139.1	0.8%	33.5

Sources: INEGI; US Census Bureau; Prudential Real Estate Investors

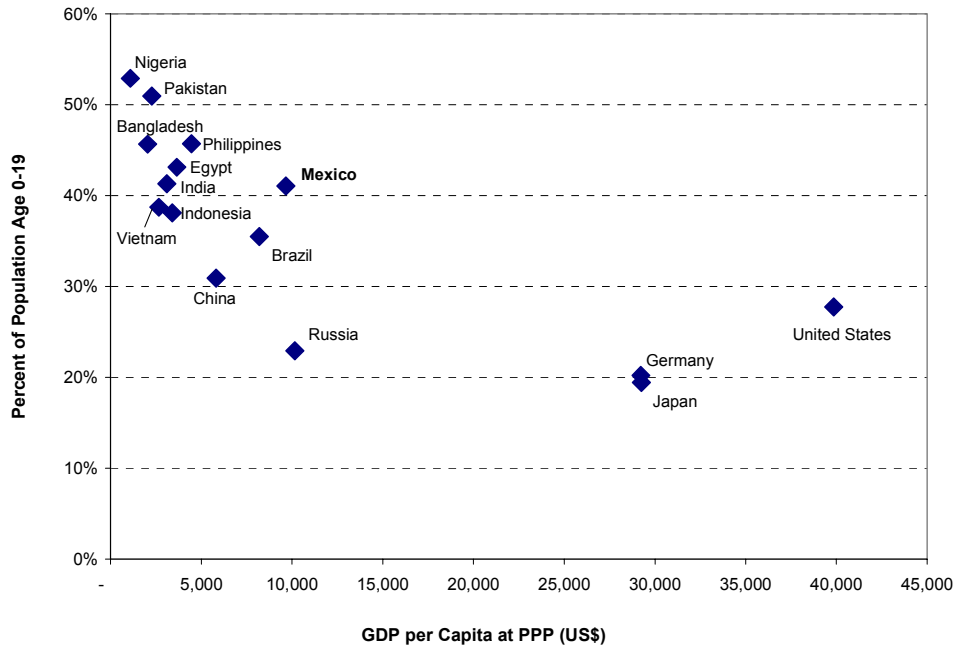
Population growth in Mexico is not occurring evenly; patterns in aging, culture, urbanization and migration together affect how the population is growing. For example, lower birth and death rates mean that the population is aging. Accordingly, in 2000, the median age of the Mexican population was 22.8, or six years more than it was in 1970. More importantly, in 1970, half of the population consisted of children and adolescents that were not yet exerting pressure on the demand for housing space. As this segment of the population matured and started to become part of the workforce, they formed new households and drove the demand for new homes.

An aging population is not isolated to Mexico; on the contrary, this is a worldwide phenomenon. In addition, the effects of an aging population living in a more stable economy ought not to be different in Mexico than in countries experiencing similar conditions. A well-documented correlation exists between the age profile of a country and its development level – wealthy countries have a more balanced age distribution, while developing countries tend to have a disproportionately large percentage of youth.

Exhibit 2 illustrates this relationship in the world’s 15 most populous countries by depicting how countries with higher per capita GDP (based on purchasing power parity, as calculated by the International Monetary Fund) are, in general, also those with a lower share of youth.

The main causes of the shift in age distribution in Mexico are an acute fall in fertility rates and higher life expectancy. Today, fertility rates are half of what they were only three decades ago.

Exhibit 2: Per Capita GDP Based on PPP Versus Share of Population in 0-19 Year Range



Sources: US Census Bureau; IMF; Prudential Real Estate Investors
Note: Estimates for 2005, 15 most populous countries.

Furthermore, Mexicans today enjoy an improved standard of living, translating into a higher life expectancy and an increase in the number of adults and senior citizens. As lower fertility rates and higher life expectancy appear to be permanent trends, they are having a profound effect on the size of the average urban Mexican household.

Mexican households are getting smaller. After having peaked in the 1970s (at 5.8 people per household), average urban household size has been decreasing, standing at 4.9 in 2000. While lower population growth rates are largely driving the reduced size of households, it is also a direct result of considerable changes in deeply rooted traditions. Mexican families, traditionally large when compared with Western European and US standards, are shrinking, even in cities with high population growth rates. This change generally follows increased urbanization and development, which have been occurring in Mexico throughout the past decades.

Mexico is now predominantly an urban country, with economic factors driving increased geographic mobility. Urban population growth reached 5% in the 1960s and 1970s. Today 71% of Mexico's population lives in urban areas, up from 59% in 1970. Most of the country's growth will continue to be in urban areas.

The most compelling example of Mexico's heavy urbanization is Mexico City, the country's capital, and the adjoining cities that form its metropolitan area. At almost 18 million people in 2000, the Mexico City metropolitan area presents both the disadvantages and benefits encountered in emerging countries' largest cities. One of the largest metro areas in the world,

Mexico City accounts for one in every four people that live in the country's cities. Furthermore, the 95 cities with more than 100,000 inhabitants account for 60% of the country's population.

For many years, internal migration in Mexico has basically followed one pattern: movement from the country's rural, poor areas into its booming, wealthiest cities, such as Mexico City and Guadalajara, both of which are in the center of the country. More recently, however, other regions have become major attractors of migration flows. Between 1995 and 2000, the northern states that border the US, such as Baja California and Chihuahua, were net migrant attractors. Altogether, the five Mexican states along the US-Mexico border received almost 1 million immigrants between 1995 and 2000, or about 460,000 people in net terms, i.e., after accounting for migrants that settled only temporarily in border cities.

The central and eastern states, where some of the country's largest cities are located, also attracted people between 1995 and 2000. Surprisingly, the Federal District posted the most negative net migration rate in the period, at -5.6%. It did, however, receive as many as 455,000 people during the five-year period – second only to the neighboring state of Mexico, which received more than 850,000 migrants. The Mexico City metropolitan area includes the Federal District and several adjoining cities in the state of Mexico. In fact, the suburbs that belt Mexico City have been expanding very rapidly, while the central area's population has stabilized.

A third magnet was in the states of the Yucatan peninsula, particularly Quintana Roo. Here, newcomers were generally motivated by the employment opportunities created by the region's tourism industry. Finally, the less-developed states in the country's southern and northern regions lost more people than they attracted between 1995 and 2000.

The profile of Mexico's population is promising from a housing demand standpoint. While income per capita is higher than that of other populous developing countries shown in **Exhibit 2** (with the exception of Russia), the share of youth is also high at 41%. On a relative basis, while Mexico accounts for 1.6% of the world's population, 1.8% of the world's youth live in the country. Today, these figures translate to more than 43 million Mexicans under the age of 19.

To estimate housing needs, one must first identify future homebuyers by looking at those who are likely to become heads of households in the near future. In Mexico, the percentage of people that head a household jumps from 3% between 14 and 19 years of age to 30% between 25 and 29 years old. This means that almost one-third of people entering adulthood will head a household within a 10-year period.

The increased number of adolescents turning adult-age confirms the strong demand for housing amid decelerating population growth. Today, the number of households in Mexico is growing at a rate close to 3% per year, while the population has not grown at such a pace since the 1970s.

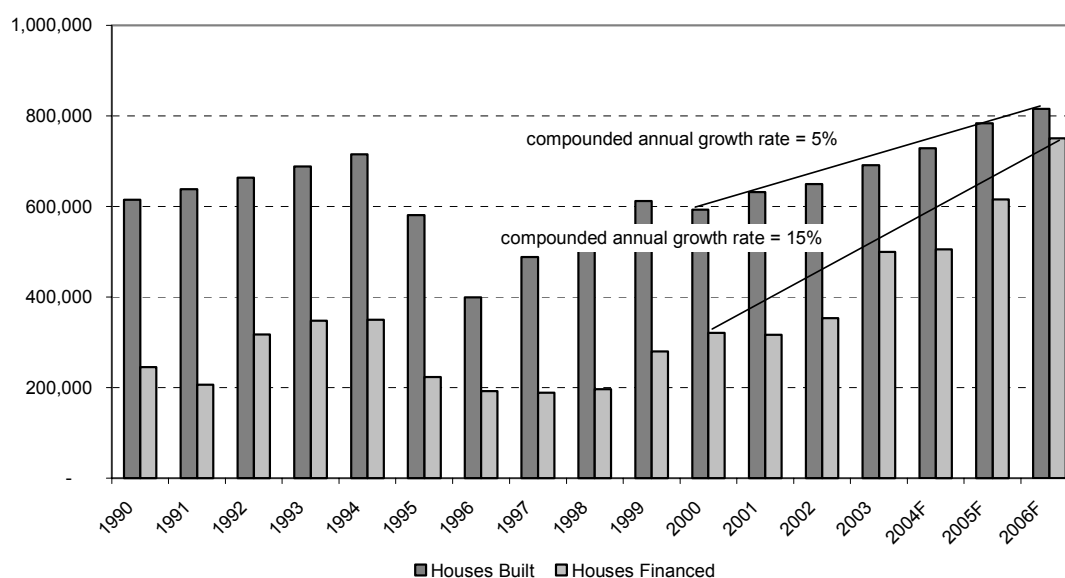
During the last decade, more than 530,000 new homes per year were added to the market. According to the 2000 Census, Mexico had 21.9 million houses that year, and it is estimated that the stock is now growing at the same rate as new household formation – about 3%, or more than 750,000 houses, per year on average.

Mexico's Housing Today

Over the past decades, Mexico has undergone profound changes in its demographic and economic profiles. Notably, the country experienced strong population growth throughout the 1970s and 1980s, while at the same time its cities increased in size. Its formerly agriculture-based economy has shifted to one that is not only much more diverse, but is now dominated by the industrial and service sectors. All these changes have transformed the demand for housing throughout Mexico and shaped the country's current housing stock.

The historical statistics of the Mexican housing sector reveal an unbalanced pattern. By analyzing the number of homes produced since 1990, two significant developments emerge: an upward trend, driven by the robust rate of household formation and then a correction leading to a temporary deceleration starting in 1994.

Exhibit 3: New Homes Built and Financed



Sources: Softec; CONAFOVI; CANADEVI; Programa Nacional de Vivienda; Prudential Real Estate Investors

Exhibit 3 shows that the upward trend in the number of homes built tracks household formation rates, except during periods of economic instability, when important deviations occurred. Similarly, the number of housing units built are directly correlated to the number of houses financed (or the number of available mortgages). Future expansion of Mexico's housing sector will be a result of the same factors. Robust demographics will continue to support demand for new homes. However, this latent demand will only be triggered by the right combination of economic factors, among them low interest rates and the availability of mortgages.

Vicente Fox was elected president of Mexico in 2000, on a political platform that promised to modernize the country's institutions, including those directly linked to the housing sector. President Fox has struggled to get many of his campaign promises fulfilled. But despite these setbacks, his government has been able to support a far-reaching stimulus to the housing sector.

The government has recognized that the involvement of public and private participants is vital to align the supply of new homes with demand. Accordingly, the government plans to aggressively increase the number of mortgages provided by the sector's public and private sources. The plan aims to finance 750,000 units per year by 2006. To accomplish this, the number of new mortgages issued must increase by 15% per year during a catch-up period of five years and stabilize thereafter at a rate closer to the actual growth in demand. The new housing policy aims to strengthen housing by:

1. Increasing the resources channeled to the sector.
2. Expanding private sources of housing finance.
3. Making credit and origination standards uniform to deepen the market.
4. Supporting the lower-income segments under a plan of direct, targeted subsidies.
5. Supporting the development of a secondary market for MBS.

Currently, Mexico's mortgage credit comes mainly from three entities: Fovissste, Infonavit and SHF. Together, these entities are responsible for about 90% of all mortgages originated in the country. Fovissste is a combination low-cost mortgage fund and pension plan program for public-sector employees. Infonavit is the equivalent of Fovissste for employees of all private companies. Both entities are funded through a 5% mandatory savings program.

SHF (Sociedad Hipotecaria Federal) is a federal development bank. It emerged in 2002 to take on a role much like Fannie Mae's, facilitating mortgage financing for low- to moderate-income buyers. It lends money to registered financial intermediaries, banks and mortgage banks, which in turn lend SHF-guaranteed funds to individual borrowers. SHF also has systematically provided construction lending to private housing developers. SHF is a key player in the future of the primary and secondary mortgage markets in Mexico.

Under the government plan, the goal is for Fovissste, Infonavit and SHF to be the catalysts in the evolution of a strong housing finance system that ultimately will look to the secondary market and long-term bond investors for capital. As with Fannie Mae, SHF is facilitating the standardization of mortgage products and procedures; improving foreclosure, appraisal and registry systems and institutions; and encouraging the evolution of private mortgage insurance. Infonavit is taking the lead in introducing and issuing MBS. The first mortgage securitizations in Mexico occurred in 2003. In the years to come, MBS will likely be one of the drivers of growth in Mexico's housing sector.

The housing sector is expected to become less dependent on government policy, largely through measures aimed at strengthening the institutions that support it, guaranteeing that current achievements outlive any given administration. The government's role is changing significantly; instead of being an operator and direct financier, it increasingly focuses on policymaking and regulatory issues.

As in any large country with strong household growth rates, total housing production must also be aggressive. This is the case in Mexico. However, the number of self-built and developer-built homes varies widely and is directly correlated with the availability of mortgages. The self-built market includes units that are constructed gradually, on land usually lacking proper licenses that

may not be titled to the occupant, and often lacking basic services such as water, electricity and sewage. Mortgage financing is usually not available for this market.

The developer-built market comprises homes constructed by professional homebuilders and sold with mortgage financing. The homes have official permits and all municipal services, and the land is registered and titled to the buyer. A review of total housing production in the past decade shows that the number of self-built homes increases when mortgage financing dries up.

The Mexican housing sector is highly fragmented. Mexican homebuilders vary widely by geographic coverage and size, ranging from niche-oriented developers that build a few houses per year to those with a nationwide presence that can build thousands of units per year. In general, homebuilders don't finance homebuyers directly, but they facilitate each buyer's approval with a lending institution. Homebuilders have access to the mortgage providers' criteria and can apply the same criteria to prospective clients. Therefore, once a homebuilder identifies a qualified buyer, it is unlikely that a lending institution will deny the homebuyer financing.

Future demand for housing will mirror income distribution. However, housing production will depend on the availability of mortgages for each income segment and on the ability of Mexican homebuilders to attract growth capital and apply institutional management and technology to develop enough homes to meet such demand.

Looking Ahead: Ten Trends in Mexican Housing

We have identified 10 trends that will affect Mexico's housing sector in the years to come. Some involve secular trends, such as those driving demand, while some are the direct result of actions now being taken. These trends fall into four categories: demand, supply, institutional framework and financing.

Trend #1: Demographic forces support demand

With its young population, Mexico is set to experience strong household formation rates for years to come. Although population growth has slowed considerably in Mexico, the effects of a still young population should drive demand for at least two more decades.

Mexico's housing deficit is estimated to range between 4 million and 6 million units. The deficit is typically calculated by determining the number of families currently in need of housing because they live in substandard conditions, plus existing houses that need significant improvements or expansions.

Although the deficit imposes pressures on the market, actual demand is in fact almost independent of it. Year after year, households are formed as adolescents enter the early-adult ages, divorce rises, migration waves increasingly populate some states and existing homes wear out. Additionally, as households reach higher income levels, they seek better quality housing. Because household formation is still quite high in Mexico, most of the market's effort going forward rests on responding to this annual demand.

We assumed that the increase in the housing stock would equal 98% of the net number of households formed in the next decades, which is in line with official projections. This would represent an average of 850,000 new homes per year between 2005 and 2020 (see **Exhibit 4**), after which the rate of household formation will start to slow.

Exhibit 4: New Housing Demand Forecast

	Total Households	Annual Growth	Increase in Households per Year in 5-year Period	New Homes Needed per Year in 5-year Period
1990	16,202,845			
1995	19,848,319	4.1%	729,095	714,513
2000	22,640,391	2.7%	558,414	547,246
2005F	26,695,810	3.4%	811,084	794,862
2010F	30,998,714	3.0%	860,581	843,369
2015F	35,418,133	2.7%	883,884	866,206
2020F	39,745,480	2.3%	865,469	848,160

Sources: INEGI; CONAPO; Prudential Real Estate Investors

Trend #2: Expansion of the homebuyer base

One limit of Mexico's current housing finance system is that most of the population does not qualify for a mortgage. This includes most of the self-employed and those that are part of the informal economy. According to UN estimates, the size of the Mexican informal economy is between 25% and 35% of Mexico's GDP. Infonavit and SHF have put in place initiatives to make mortgage financing available to this segment of the population. Recently, private-sector mortgage providers and homebuilders have also launched programs aimed at this segment.

The challenge includes creating incentives for those in the informal economy to join the formal economy and to improve credit-underwriting tools and databases that recognize potential homebuyers' income that is not reported to the tax authorities but can be verified. For example, often service providers receive a large share of their salary through tips, which are rarely reported to the tax authorities. However, recent tax legislation made mortgage interest deductible, creating an incentive for potential homebuyers to file tax returns to obtain the benefit. To this can be added efforts to develop databases that monitor spending history, which allows this segment of the population to seek home financing.

Trend #3: Growth of homebuilders

Mexican homebuilders develop about 75% of all new homes added to the market each year. Together, the 10 largest players are responsible for close to 30% of total housing production, and none has a market share of more than 10%.

However, Mexican homebuilders are getting bigger and should continue to do so as they seek to expand nationally. Given the local nature of real estate, it is not surprising to find that a large share of homebuilders have concentrated first on their region of origin. True national players are rare, but this is rapidly changing. Some homebuilders have grown considerably in the last decades by merging and acquiring former competitors or through opening subsidiaries beyond their traditional core markets.

Lately, financial institutions have shown a preference for working with larger and more sophisticated companies. This is leading homebuilders to emphasize growth as a means to access financing more readily. Going forward, larger, efficient companies with stronger balance sheets will be better suited to access new sources of long-term capital that are becoming increasingly available in Mexico's capital markets. Mexico's growing capital markets (both in size and scope) are proving to be a powerful incentive for homebuilders to grow their operations.

Trend #4: Larger companies going public

One result of the growth of homebuilders is their increased need for equity capital. Homebuilders' access to the equity capital markets has been expanding rapidly. Six homebuilders are listed on the Mexican stock exchange. Three homebuilders made IPOs in the last 12 months; these were the only three IPOs made by any Mexican company (in any sector) since 2001. At least two other homebuilders are mulling IPOs. The six publicly traded companies have a joint market share of about 23% of the homes sold by developers, which indicates the potential for them to grow as the market consolidates further.

Despite all the IPO activity since 2003, however, this trend is nearing its limit. Five of the 10 largest homebuilders in the country are public companies, and at least two more are set to list in the upcoming months. Mexico's stock market is not developed enough to efficiently raise capital for smaller companies. Further, the float of public homebuilders' stock is relatively thin, and potential secondary offerings from these same companies should help to respond to the market's investment appetite in the near future.

Trend #5: Stronger institutional framework

Congress is now discussing a new housing law that seeks to better define the relationship between governments and the private sector. The main drawback to the current relationship is the inconsistent approval processes at the federal, state and local levels. What is being sought is transparency in the approval processes. And a market-driven mindset will allow cities that offer a more organized (and transparent) framework for land-use planning to qualify for better financing terms from mortgage providers. Governments will also be rewarded for providing incentives for new housing production. This is expected to help improve the quality of planning for housing needs, which is generally very poor at the local level, particularly in smaller cities.

Most of the organized activity of market participants today focuses on making the housing sector less dependent on government policy. Accordingly, the industry has a strong interest in de-politicizing the sector. Central to this is a financial system that is much more than a mere conduit of funds, but rather one that mobilizes and allocates resources, as well as disciplines market participants. In that spirit, trade associations are lobbying to make Infonavit less vulnerable to political pressure and to convert it into an independent entity much like Mexico's central bank. The task is not easy, as the housing sector has historically been a source of political power on all levels. The challenge remains, however, and we should see increased movement in this direction between now and the next presidential election in 2006.

Trend #6: Greater information sharing

Mexico, as well as other Latin American countries, does not have a history of information sharing among market participants. This lack of transparency exists despite institutions, such as financing providers and homebuilders, gathering a wealth of information over the past few years.

A centralized database is needed that can help market participants, such as financial institutions, homebuilders, governments and legislators, identify housing demand and supply in detail. Currently, trade associations are sponsoring initiatives to develop such a database, and its implementation should improve the precision of market projections and efficiency across the board. Without it, the sector will continue to rely on imprecise forecasts, which generate the risk of imbalance and oversupply. For the public in general, it should prove an invaluable tool for tracking housing production, sales and prices at the local level. It will also be a tool for understanding payment patterns during mortgage terms, which in turn will lower default-risk spreads and eventually help lower mortgage rates.

An additional factor that is also changing the overall transparency of the sector is the growing number of public homebuilders. These companies are expected to meet much stricter requirements regarding financial and operations reporting, as they open their books to the scrutiny of investors and analysts. This is not only healthy in terms of streamlining internal procedures, but also permits information sharing and market benchmarking, which is crucial to the efficiency of the market.

Trend #7: Increased specialization of financial institutions

The Mexican housing system encompasses the activities of pension-fund-like agencies that provide financing to employees (such as Infonavit and Fovissste), private financial intermediaries (mortgage banks and commercial banks), homebuilders, and the end clients.

We expect participants in Mexico's financing framework to become increasingly specialized. One such example is the changing role of the national mortgage company SHF, which was, up to now, a source of mortgage financing, directly or via financial intermediaries. SHF is funded by the central bank and direct grants from the International Monetary Fund. Recently it was allowed to raise funds in capital markets. Over the long run, SHF will shift its focus from being a provider of mortgage financing to becoming a provider of default insurance to MBS pools.

A smoothly functioning market for MBS depends on very specialized players, including originators, conduits and servicers. We expect, therefore, to see more focused participants on all levels, as well as an increasingly efficient market.

Trend #8: Financing for the middle class

As companies continue to seek economies of scale while focusing on lower-income households, we expect them to increasingly shift their attention to higher-income (and higher-margin) subsectors. As financing sources continue to diversify, smaller players will also have a chance to increasingly tap into these sources.

The market for homes priced above \$50,000 is expanding. The development of the Mexican economy, along with the demographic changes discussed earlier, has been bringing more households into this tier. And the resumption of lending by commercial banks will serve as an engine for bringing the middle class into the market.

Exhibit 5: Sales Projection by Market Segment

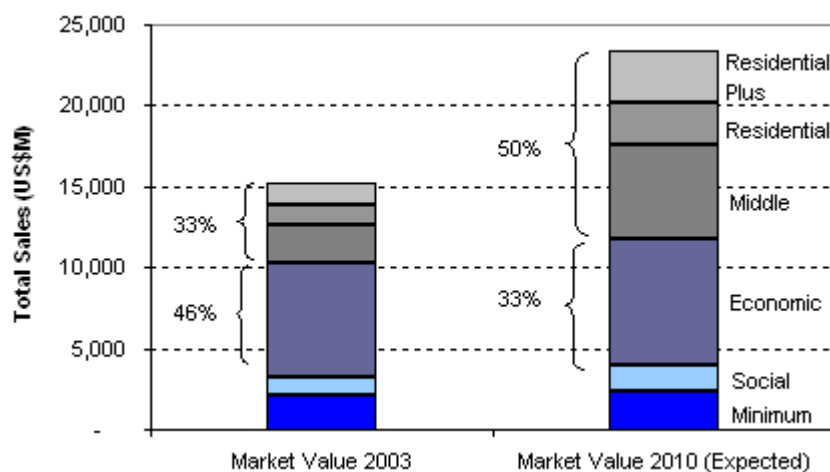
Housing Segment	Average Unit Price	Unit Sales 2003	Unit Sales 2010E	Annual Growth Rate 2003-2010E
Minimum	\$7,000	292,100	337,800	2.1%
Social	\$16,000	74,421	101,897	4.6%
Economic	\$26,000	268,275	299,045	1.6%
Middle	\$58,000	41,956	99,865	13.2%
Residential	\$128,000	9,287	20,360	11.9%
Residential Plus	\$278,000	5,004	11,597	12.8%
Market Total		691,043	870,564	3.4%

Sources: Softec; Prudential Real Estate Investors

The market sales breakdown in **Exhibit 5** shows how unit sales growth is expected to concentrate in the middle- and higher-income segments, where commercial banks now focus their mortgage lending efforts. Mortgages issued by banks almost disappeared from the market from 1996 to 2002, after which activity slowly started to resume. The number of bank mortgages will likely more than double in the next two years, reaching over 50,000 houses financed per year by 2006.

A major shift in the profile of the Mexican housing market will result from robust growth in the number of middle- and residential-segment homes (see **Exhibit 6**). So far the market has been dominated by the production of houses with an average price of about \$25,000. This segment is expected to maintain its high volumes, but stronger growth in the sale of more expensive units means that the latter will gain increased importance on a revenue basis.

Exhibit 6: Market Value by Segment



Sources: Softec; Prudential Real Estate Investors

Trend #9: Diversified pool of funds

Just a few years ago, Mexico dealt with a volatile economic environment that shook the financial system and translated into price inflation. As a result, local risk was considered high, and the economy had to cope with high interest rates.

More recently, however, Mexico's economy has made long strides toward stabilization. The country's entrance into NAFTA and other trade agreements boosted the manufacturing sector, while a new political stance brought modernization to long-stalled institutions. Foreign investment increasingly followed suit in the late 1990s, as Mexico's risk became much more tolerable for international investors. A major milestone was Moody's upgrade of the country's sovereign risk from speculative to investment grade in 2000, followed by similar actions by S&P and Fitch in 2001. Suddenly investments in the country achieved an enhanced credit status, and interest rates dropped accordingly, while investors accepted longer-term securities.

A lower-interest-rate environment has powerful implications for the economic development of a country accustomed to a high cost of capital. More affordable credit means that companies have better alternatives for financing production, while consumers borrow more, provided that sufficient sources of funds are available in the marketplace.

The pension fund industry is new to Mexico. The Afores, as they are known by their Spanish acronym for Retirement Fund Administrators, were introduced in 1997 to replace, in the long run, the pay-as-you-go public system. Afores are defined-contribution plans that manage 6.5% of employees' salaries, plus an additional 5.5% contributed by the government.

The system has experienced rapid growth since its inception, with assets under management growing from \$5 billion to \$35 billion between 1998 and 2003. Following the industry's growth, Afores became increasingly important participants in Mexico's capital markets. Initially, Afores' investments were limited to local government securities, which still account for about 90% of their holdings. But this has changed, and they can now invest in Mexican public and corporate bonds quoted in pesos or certain foreign currencies, as well as in derivatives. Afores are a key purchaser of MBS now being issued in the Mexican market and should continue to be so.

Besides local pension funds, international institutions are also eyeing Mexico's housing sector. They are potential providers of both equity and debt capital, and many are already investing in the sector. Cross-border securitizations are starting to occur, thus directly addressing currency risk. Nevertheless, a stable economy makes peso investments more attractive to foreign investors, which is crucial to the housing sector.

Trend #10: Mortgage securitization

Sustainable development of the MBS market will only be possible with the corresponding creation of a secondary market for these securities. Since December 2003, when the first MBS were issued in Mexico, issuance has totaled \$330 million. Mexican pension funds have been the major purchasers. And given the expected boom in Mexico's pension industry, these entities are likely to continue being the preferred investors in these assets. Legislation only allows Afores to

invest in investment-grade bonds. Not surprisingly, MBS issued in Mexico over the last few months include credit-enhancement features to make them more appealing to these institutions. Similar to US federal housing agencies, Mexico's SHF will provide guarantees for MBS originating from private institutions.

A well-oiled MBS market calls for the liquidity that comes from secondary trading. Mexico's housing market still has a long way to go before it reaches this level of efficiency. Further development will only be achieved when sufficient demand exists for such instruments. But the main components are already in place: a mature housing market backed by consistent demand; skilled and efficient homebuilders; increasingly sophisticated mortgage providers; a growing pool of institutional investors; a developing capital market; and an institutional framework that ensures the system will be maintained.

Conclusion

Notable changes have occurred in the way houses are built and financed in Mexico. But wider changes have also affected the country as a whole in terms of its political and economic framework. In all, the housing sector is now at a much more mature stage.

While Mexican housing demand is abundant, it is often difficult for households to qualify for a mortgage. This is a key factor in a country where most of the population depends on some sort of financing to buy a home. Substantial improvements have been made during the past 10 years – improvements that have readied Mexico's housing sector for the next level of development.

The trends noted in this report will help to shape the near future of the housing sector. Generally, they all indicate positive movements that can affect investment strategies. **Exhibit 7** shows the expected impact of the trends on the housing sector and how long their effects are likely to last.

Exhibit 7: Impact of Housing Trends

	Impact to Sector	Expected Timing
Demand Trends		
1. Demographic forces	Major	Long term
2. Expansion of the homebuyer base	Major	Medium term
Supply Trends		
3. Growth of homebuilders	Major	Medium term
4. Large companies going public	Limited	Short term
Institutional Trends		
5. Stronger institutional framework	Major	Medium term
6. Greater information sharing	Limited	Long term
Financing Trends		
7. Specialization of financial institutions	Limited	Medium term
8. Financing to the middle class	Major	Short term
9. Diversified pool of funds	Major	Medium term
10. Mortgage securitization	Major	Short term

Source: Prudential Real Estate Investors

Of course, the risk always exists that some (or even most) of these trends won't last long or don't have the expected impact. We thus reemphasize the fundamental facts that have supported the market over the past few years. On the demand side, the country's demographic trends indicate strong household formation rates in the years to come. At the same time, economic stabilization is allowing more families to consider purchasing a new home for the first time.

On the supply side, Mexico boasts an assortment of homebuilders that have developed the capacity to efficiently link potential homebuyers with the country's public or private mortgage financing sources. This active participation of mortgage providers is paramount to the sector's success. The country is in the process of establishing institutional foundations that will allow sustainable growth in the sector. As the sector becomes increasingly detached from short-term political influence, it is finally becoming possible to devise and implement long-term strategies.

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