

Market Perspective

Executive Summary

- Latin American markets fared well during the global turmoil brought on by the U.S. subprime crisis. Sectors expected to better withstand the international turbulence are those less directly dependent on trade and those driven by country-specific fundamentals such as long-term demographic shifts.
- New real estate investment is continuing in Latin America, particularly in Brazil, Chile, Argentina and Mexico.
- Housing and retail are currently the top attractors of foreign capital. In Brazil, a boom in housing construction is beginning as financing reaches middle- and lower-income households.
- Office markets are benefiting from economic growth across the region. A few years of slower development activity (following years of high activity), along with steady absorption, has driven vacancy rates to low points in all major cities in the region. Rents are rising from Santiago to Mexico City, and development is now resuming.

Regional Economics

Latin American economies emerged relatively unscathed from the turmoil in the global financial markets in 3Q. Strong fluctuations in the region's currencies and a brief interruption in capital inflows occurred in July and August as credit conditions tightened worldwide. However, by mid-September most currencies had returned to pre-subprime crisis levels, and inflows of foreign capital had resumed in Latin America.

The region, which was very sensitive to shocks during the past two decades, has fared much better during the recent external turbulence. In general, macroeconomic fundamentals are currently much stronger than they have ever been. Latin America's main problem in the '80s, inflation, is largely under control, and the main economies in the region have greatly reduced their foreign debt levels.

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Latin American countries continue to benefit from high commodity prices, strengthening the region's exports. Record high oil prices have boosted revenues in Mexico and Venezuela, while the Chilean economy has benefited from the high price of copper (one-third of the world's copper comes from Chile). Raw materials, such as iron, have also been important for Brazil, as strong demand from China keeps prices high.

Growth in Latin America should not be greatly affected by a mild slowdown in the U.S. Most countries now have a far more diversified export base than a few decades ago, with the surge of exports to countries such as China and India. Brazil's GDP is forecast to grow 4.7% in 2007, while Argentina and Chile should grow 7.7% and 6.1%, respectively. With about 78% of its exports headed to the U.S., Mexico's economy is expected to grow by just under 3%, or less if the U.S. economy decelerates further.

The region has been enjoying the benefits of high international prices for its exports. However, Latin America is still relatively closed to foreign trade versus other emerging regions, especially Southeast Asia, hence the importance of furthering trade liberalization in the region. During 3Q, new activity included Mexico's starting free trade negotiations with South Korea and Chile's talks with Australia. Chile, which leads the region in terms of trade openness, saw its trade agreement with Japan go into effect in 3Q.

High international prices and hot internal economies are driving a fear of inflation across the region. In Mexico, August inflation data showed a 4.05% year-on-year increase, which is more than the 3% target. Although the figure is above the upper limit of 4%, the variation is small enough for local authorities to control inflation via monetary policy.

Mexico had a politically charged quarter as the government negotiated the approval of a long-awaited fiscal reform. The new legislation is expected to boost government revenues by 2% of GDP, eventually lowering the country's dependence on declining oil revenues. Reflecting this change, Fitch Ratings upgraded the long-term foreign currency credit rating of Mexico to BBB+ from BBB, a move later replicated by S&P.

Politics took center stage in Argentina, in the run-up to the October presidential elections. The country continues to expand quickly, but double-digit inflation is a real concern. In contrast, both Colombia and Chile are enjoying strong economic growth with milder inflation rates, although recent price spikes were enough to prompt an increase in interest rates in both countries. Brazil is an exception in the region, with interest rates continuing to fall. Despite smooth sailing in the Brazilian economy, the government is struggling with its political agenda and diminishing support in Congress.

Capital Markets

Capital markets in Latin America experienced a volatile 3Q. After reaching record high levels by midyear, most indexes tumbled as credit conditions tightened worldwide and foreign investors retrenched. However, the fact that Latin America's largest economies have their finances in order provided comfort to investors. As developed countries' central banks put liquidity back

into markets, stock prices in the region rallied, erasing past losses or even reaching record-breaking levels.

The Brazilian Ibovespa stock index continued to lead the way with a 10.07% increase in the quarter. Mexico's IPC and Argentina's Merval posted 2.76% and 0.13% losses, respectively – but not enough to erase gains since January. During 3Q, the S&P 500 was up 1.56%.

Strong foreign capital inflows were the main reason for the Brazilian stock market's performance. Real estate companies are benefiting from investor confidence and are resuming the wave of initial public offerings that began in January. Developers MRV, Ez Tec and Investur raised over US\$1.4 billion in share offerings. Shopping center administrators Multiplan and General Shopping raised a combined US\$630 million in the same period.

Brazilian real estate companies are also tapping public debt markets. Developers Klabin Segall, Company, PDG, Cyrela and Rossi announced plans to issue over US\$650 million in bonds, while shopping center administrator BR Malls announced plans for a US\$170 million issue.

The Mexican IPC saw weaker performance due to worries regarding the effect of a U.S. slowdown on Mexican companies. Money transfers from Mexicans living abroad, an important source of foreign capital, halted its upward trend in 3Q. An estimated 40% of Mexicans in the U.S. work in residential construction, which helps to explain the lower level of remittances.

Bond issues remain the preferred means for Mexican companies to raise capital. Mexican non-bank mortgage lenders Metrofinanciera and Credito y Casa, as well as homebuilder Urbi, raised a combined US\$370 million in bond markets during 3Q. Mexico's government-run housing fund, Infonavit, sold US\$250 million of mortgage-backed securities in July. Infonavit also announced the issuance of US\$240 million in mortgage-backed securities in September.

Industrial

After a slowdown in 2Q, Mexican industrial production picked up steam in 3Q, with the auto industry leading the recovery. Automotive companies continue to invest in and transfer operations to Mexico.

Autoparts manufacturers Bosch and BorgWarner recently announced plans to invest US\$90 million and US\$67 million, respectively. Bosch will expand its manufacturing facilities in Juarez and Toluca, while BorgWarner will construct a manufacturing facility in Saltillo, in the northern state of Coahuila. ArvinMeritor, a shock absorber manufacturer, announced that it will close a facility in Canada and transfer its operations to Mexico.

Investments in the Mexican auto industry should remain solid in the near future. South Korean carmaker Bering and French tire maker Michelin are both planning large investments. Bering will invest US\$800 million in a Campeche facility, while Michelin intends to invest US\$740 million to build a new tire factory in Mexico. Such new investments require high-grade facilities and often bring together a string of smaller suppliers, which continue to be an important component of demand for industrial real estate in Mexico.

The automotive industry is driving industrial production in other parts of the region as well, with auto production and sales posting double-digit growth in several countries. Nowhere in the region is industrial real estate investing as developed as in Mexico, however. Despite a slowdown in the pace of new transactions as a result of the financial worries in global markets, no one expects a reduction in prices. Some transactions due to close in 4Q, as a matter of fact, point to a further decrease in cap rates.

Brazil, the region's largest economy, is also home to a mostly outdated industrial infrastructure, at a time when tenant interest for quality industrial space is on the rise. Brazilian industrial output was up 6.8% in July compared with the same month in 2006, while auto sales rose by 31.8% in the same period. Exports and internal consumption are driving this growth, which is increasingly attracting real estate investors. Brazil's interest rate, which has been steadily declining despite rising rates elsewhere, is reflected in higher prices. In the past 12 months, industrial cap rates have moved down at least 100 bps.

Retail

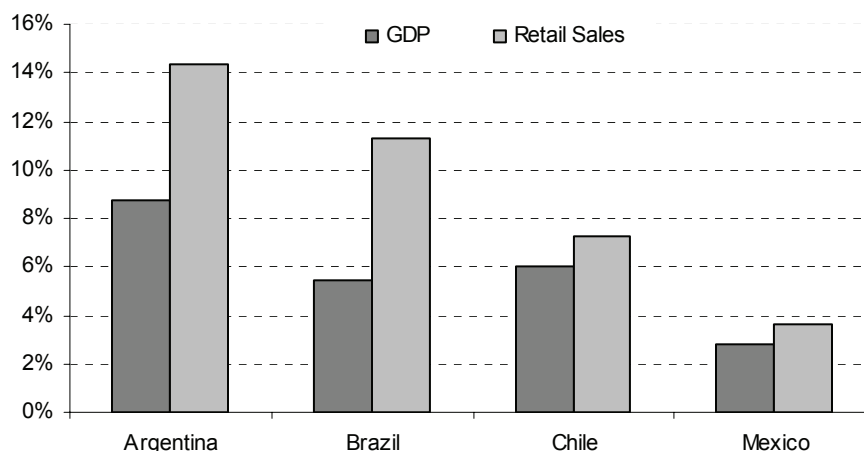
The retail sector is expanding quickly in Latin America. Driven by ever-increasing credit availability and economic growth, retail sales remain on the rise. The third quarter was no exception. The Mexican retail association ANTAD reported that total sales rose 8.8% year-on-year in August. In Brazil, July retail sales rose 9.8% year-on-year, while Argentina showed an impressive 21.8% yearly growth. In all cases, retail is expanding at rates nearly twice that of each country's economy.

Mexican retailers are benefiting from steady economic growth. Consumer demand, fueled by wider credit availability and wage growth, continues to drive retail sales. Personal consumption has grown an average of 4.7% per year since 2004 and is forecast to grow 3.7% in 2007.

Retailers in Mexico continued to move into the consumer credit market. Supermarket chain Soriana is set to open a finance company in joint venture with the country's second-largest commercial bank, Banamex. Wal-Mart started banking operations in Mexico in September.

Retailers in Chile continue their regional expansion. Constrained by a small local market, but with strong balance sheets, Chilean retailers are furthering their presence in other Latin American countries. Chilean retailer Cencosud announced plans to open 10 stores in Argentina. In Peru, Chilean supermarket chain La Polar plans to open three stores in 2008, while Ripley, a department store, announced plans to invest US\$200 million in the construction of malls and stand-alone stores. Another department store and mall operator from Chile, SACI Falabella, is investing US\$30 million to open two stores in Colombia.

GDP and Retail Sales Growth - 2Q07 Trailing 12 Month



Source: Reuters

In Brazil, the retail real estate market is changing, as highly capitalized companies put their capital to work. After the large number of IPOs and debenture issuances in 2007, consolidation of portfolios via acquisition is occurring. Shopping center operator BR Malls, currently the owner of the largest portfolio of shopping centers in the country, paid US\$550 million for participations in five existing properties in the states of Sao Paulo and Rio de Janeiro. Competitor Iguatemi acquired stakes in three shopping centers during the quarter.

The capital markets should continue to fuel acquisition and new development activity in Brazil. Shopping center operators Multiplan and General Shopping went public in 3Q, raising a combined US\$637 million. Among companies officially working on initial public offerings are a small shopping center operator and two of the country's largest retailers.

Residential

Residential markets in Latin America mirror the progress in each country's credit markets. With available credit, mortgage issuance in the two largest economies in the region, Mexico and Brazil, reached a high level in 3Q. The residential market of Argentina, on the other hand, is still waiting for the availability of credit to become a reality.

The Mexican mortgage market grew in tandem with home sales, which continue to rise rapidly. In July, new mortgages increased 24.3% year-on-year to US\$20.94 billion. Mexico's largest banking group, BBVA Bancomer, expects to issue about US\$48 billion in new consumer and mortgage loans over the next three years.

To cope with increasing mortgage demand, bond issuances were the preferred means of raising capital for Mexican mortgage lenders in 3Q. Infonavit, Mexico's government-run housing fund, sold US\$250 million of residential mortgage-backed securities in July and announced plans for a similar size issuance in 4Q. This year Infonavit expects to issue between US\$742 million and US\$1.29 billion in RMBS. Private mortgage lenders also tapped capital markets in the quarter, with two of the largest mortgage banks raising a combined US\$265 million in bonds.

Despite being in the early stages of development, the mortgage market in Brazil is growing at a remarkable pace. Brazilian banks extended US\$797 million in mortgages in July, up 95% year-on-year. From January to July, the volume of new mortgages issued grew 72% year-on-year to US\$4.30 billion.

A sector traditionally dominated by government institutions, the Brazilian mortgage market is starting to attract the attention of the private sector. With an eye on the up-and-coming low-income segment, local and international banks are improving their financing terms. Brazilian mortgage lender BM Sua Casa will offer 30-year mortgages, while commercial bank Unibanco announced plans to issue up to US\$7.65 billion in mortgages over the next five years.

Brazilian real estate developers continued to tap the local stock market in 3Q. Three developers had initial public offerings, raising over US\$1.4 billion. Among them is a company specializing in low-income housing, the second in the segment to go public this year. Five other developers announced that they are working on share offerings. Developers are also looking into fixed income issuances. Five publicly traded developers issued debentures in 3Q, raising a combined US\$680 million between bond and debenture issuances. The capital is needed to maintain these companies' aggressive expansion plans, and is being used in the acquisition of land positions and smaller competitors.

Office

Economic growth is driving vacancy rates across the region to low levels. All major markets in Latin America are going through a period of declining vacancies amid rising rents. New construction is evident in all markets, although not at levels pointing toward an oversupply.

Construction activity increased supply in Mexico City, Latin America's largest office market. However, strong demand has kept absorption at high levels, driving vacancy rates to their lowest levels this year. Vacancy rates have declined steadily since 2006, falling from almost 10% to the current 6%.

Although the market is experiencing strong absorption and low vacancies, average asking rents have not moved up significantly in Mexico City. Average rents for the market, including new and existing stock, is stable at US\$23 per square meter per month. Considering only new office buildings, however, lease rates for prime office space start at US\$25 per square meter per month, sometimes reaching US\$30 for the best located Class-A properties.

Santiago, Chile's capital and the country's main office market, is very active. In spite of the rising amount of current stock, steady absorption drove vacancy rates to a negligible level of less than 1%. The city's top submarkets, particularly Las Condes, are seeing strong pre-leasing and pre-sales activity for the first time, resulting from this severe lack of available space. New development, as can be expected, is on the rise in Santiago.

In Brazil, robust economic growth is also driving vacancy rates to new lows in the major markets of Rio de Janeiro and Sao Paulo. In Sao Paulo, new construction activity is slowing somewhat, while absorption remains at strong levels. According to CBRE, in the first half of 2007, 365,600

square meters were leased, representing a 32% increase when compared with the same period in 2006. Vacancy rates currently average 10% in all Sao Paulo submarkets. Vacancy, however, is lower in the fashionable Faria Lima and Marginal regions, which also command the highest rental rates in the city.

In Rio de Janeiro, lack of development sites in downtown, the city's main office area, is resulting in a mounting wave of building conversions. These conversions were originally undertaken by local groups but are now attracting institutional investors eager to provide the funds for redevelopment or to acquire these properties upon stabilization.

Conclusion

Real estate markets in Latin America felt the effects of the subprime crisis in two ways. First, investors' immediate reaction was to seek less risky assets, particularly those closer to home. The effect was seen in debt markets, with emerging-market bond prices falling in early August, as well as in equity markets, with slumps in local stock exchanges. This first reaction practically vanished toward the end of the quarter, with financial markets in Latin America recovering most – if not all – the losses observed in the period.

A potential second outcome of the crisis is still unfolding: that is, possible consequences from a slowdown in the economies of developed countries moving across the globe, including to Latin America. The risk of such an outcome occurring is due to the increased connection between Latin America and the U.S., in particular, via trade and financial markets. However, over the past decade the region has gradually developed a stronger internal market based on local consumption, which could counter the effects of this increased linkage.

Participants in financial and real estate markets understand that a large share of the observed growth in the major Latin American countries is due to internal demand. The continuing inflow of resources into local real estate markets, including the Brazilian developers' wave of IPOs, is driven by expectations of this demand continuing via demographic forces, especially by the increase in the number of adults across the region.

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