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HVS Report: Foreign Direct Investment, Commercial Real Estate, and Hotel Development in Mexico City

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Mexico City's office and lodging markets have gradually evolved over the last decade. Investment in the country has resulted in the arrival of new companies and the expansion of many already in operation. This in turn has given rise to a growing Class A office market and increased demand for hotel accommodations. This article examines the relationship between foreign direct investment, demand for office space, and lodging demand in Mexico City—one of the largest and most dynamic metropolitan centers in the world.

Foreign Direct Investment – A Key Economic Driver

On the world stage, many economic, political, and social developments in Mexico have been overshadowed by recent media attention focused on the government's efforts to eliminate drug-trafficking violence in border regions of the country. Yet in the past 16 years, Mexico's political system has transitioned from one dominated since 1921 by one-party rule to an active multi-party democracy. Material changes to Mexico's economy include the unilateral lowering of trade barriers and entrance into GATT (now the World Trade Organization) in 1986, the 1994 signing of the North American Free Trade Agreement (NAFTA), and the nation's subsequent entrance into a similar free-trade accord with the European Union.

As shown in Figure 1, annual foreign direct investment in Mexico has grown dramatically since 1995, creating a backbone of industrial activity and supporting a trend toward job growth. These developments were accompanied by other structural economic changes, including privatization of certain industries previously controlled by the government, as well as improvements in road and airport infrastructure.

Figure 1 Mexico Foreign Direct Investment (in Billions of USD)

Year	FDI	Percent Change	Cumulative FDI
1995	9,526	—	9,526
1996	9,186	-3.6 %	18,712
1997	12,831	39.7	31,543
1998	12,416	-3.2	43,959
1999	13,869	11.7	57,828
2000	18,107	30.6	75,935
2001	29,808	64.6	105,743
2002	23,728	-20.4	129,470
2003	15,757	-33.6	145,227
2004	24,501	55.5	169,728
2005	22,425	-8.5	192,152
2006	20,103	-10.4	212,256
2007	29,084	44.7	241,339
2008	24,913	-14.3	266,252
2009	15,206	-39.0	281,458
2010	17,726	16.6	299,184
Forecasts			
2011	*20,000*	*12.8 %*	*$301,458*
2012	*23,000*	*15.0*	*324,458*
2013	*25,500*	*10.9*	*349,958*
2014	*28,000*	*9.8*	*377,958*
2015	*30,500*	*8.9*	*408,458*

Source: Secretary of the Economy, ECLAC, and HVS

Summary

Mexico City is one of the most densely populated and developed urban areas in the world. How will rising foreign direct investment amplify the dynamics of the city's office and lodging markets in the wake of the recent recession?

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Foreign direct investment decreased in Mexico in 2009, as was the case in nearly every Latin American country. Mexico's economy fluctuates with that of the United States and was particularly hard-hit during the recent economic downturn. The loss of business and tourism in the months following the H1N1 outbreak in April of 2009 made things worse. However, according to Mexico's Secretary of the Economy, Foreign Direct Investment rose to $17.726 billion USD in 2010, representing a 16.6% increase from 2009. The same source reported that in 2010 the most attractive segments for foreign direct investment were manufacturing (59.7%), commerce (14.2%), financial services (13.8%), other services (7.6%), and other sectors (4.7%).[1]

This optimism is supported by Mexico's leap in ranking on A.T. Kearney's 2010 FDI Confidence Index. Despite declining oil production, media focus on drug-trafficking crime in limited areas of the country, and the worst recession since the 1930s, Mexico remains a popular location for light industry and U.S.-based companies looking to reduce costs. The manufacturing sector, overall employment, and commercial, retail, and tourism projects in the country have continued to grow during the past decade.

According to a report published by the Economic Commission for Latin America and the Caribbean in 2010, Mexico's manufacturing and services sectors continue to receive the most foreign direct investment, at 49% and 42%, respectively. The manufacturing sector includes the production of metal products, machinery, and equipment and is closely tied to the U.S. economy, particularly the automotive industry. The services sector includes the financial, trade, healthcare, and hospitality industries, among others.

The impact of rising foreign direct investment has made its mark on the real estate sector as well. Industrial parks mirroring those across the U.S. border have been developed throughout northern and central Mexico, financed by both domestic and international investment funds and banks. Class A office buildings developed to international standards have multiplied, primarily in Mexico City, which remains the key financial and corporate center of the country. Both industrial and office assets are part of sophisticated real estate capital markets, with mid- to long-term lease periods, often in U.S. dollars, also financed by both domestic and international investment funds and banks. Department-store-anchored regional shopping centers and grocery-anchored neighborhood centers have also increased in number to serve a growing middle class, which is gradually transitioning from employment in rural and informal sectors to NAFTA-related jobs in key economic corridors. Private developers and dedicated government agencies have designed and implemented mechanisms allowing massive development of affordable and middle-income housing product, with the annual inventory also growing significantly over the last decade, providing start-up housing for young couples and families.

The rise in investment and economic activity has brought increased demand for business and leisure travel. Leisure travel continues to proliferate for many coastal and interior destinations within Mexico, which hosted over 22 million international visitors in 2010.[1] This has given rise to the development of full-service, limited-service, and economy hotels throughout the country, with more set to follow in the coming years.

Tracking Office Space in Mexico City

Foreign direct investment, coupled with population growth and the broadening of the service sector, has resulted in a growing office market in Mexico City. Total available Class A office space increased from 672,273 square meters in 1995 to 3,087,197 square meters in 2009. This translates into an average annual compounded increase of 11.5%, or 172,423 square meters of additional office space each year.

Figure 2 below illustrates the amount of available and absorbed Class A office space from 1995 through the third quarter of 2010.

Figure 2 **Historical Trend in Class A Office Space – Mexico City**

Year	Total Office Space SM	Total Office Space SF	Vacant Office Space SM	Vacant Office Space SF	Occupied Space SM	Occupied Space SF	Vacancy Rate
1995	673,273	7,247,043	130,747	1,407,348	542,526	5,839,696	19.42%
1996	720,416	7,754,486	116,327	1,252,132	604,089	6,502,354	16.15%
1997	1,037,572	11,168,321	232,834	2,506,202	804,738	8,662,119	22.44%
1998	1,210,370	13,028,302	211,461	2,276,145	998,909	10,752,157	17.47%
1999	1,394,993	15,015,565	217,805	2,344,431	1,177,188	12,671,134	15.61%
2000	1,449,293	15,600,045	141,455	1,522,607	1,307,838	14,077,437	9.76%
2001	1,659,121	17,858,613	230,421	2,480,229	1,428,700	15,378,384	13.89%
2002	1,951,044	21,000,843	387,275	4,168,589	1,563,769	16,832,253	19.85%
2003	2,245,256	24,167,711	495,941	5,338,259	1,749,315	18,829,452	22.09%
2004	2,532,920	27,264,092	510,059	5,490,224	2,022,861	21,773,868	20.14%

2005	2,820,583	30,360,473	299,679	3,225,715	2,520,904	27,134,759	10.62%
2006	3,061,723	32,956,080	183,703	1,977,361	2,878,020	30,978,719	6.00%
2007	3,132,361	33,716,421	147,145	1,583,854	2,985,216	32,132,567	4.70%
2008	3,030,685	32,621,990	143,252	1,541,950	2,887,433	31,080,040	4.73%
2009	3,087,197	33,230,280	238,056	2,562,411	2,849,141	30,667,869	7.71%
3Q 2010	3,080,938	33,162,909	295,472	3,180,431	2,785,466	29,982,477	9.59%
Forecasts							
2010	3,172,937	34,153,177	341,471	3,675,560	2,831,466	30,477,617	10.76%
2011	3,386,937	36,456,651	384,471	4,138,407	3,002,466	32,318,244	11.35%
2012	3,600,937	38,760,126	427,471	4,601,255	3,173,466	34,158,871	11.87%
2013	3,814,937	41,063,600	470,471	5,064,103	3,344,466	35,999,498	12.33%
2014	4,028,937	43,367,075	513,471	5,526,950	3,515,466	37,840,124	12.74%

Source CBRE and HVS

In the period from 2006 through the third quarter of 2010, vacancy rates remained below 10%. Vacancy rates are forecast to move slightly upward through 2014 as supply increases, which have been minimal over the past few years, continue to ramp up.

Over the past 20 years, office development in Mexico City has taken place along two key axes. The first, known as the Reforma to Santa Fé corridor, extends due west along Paseo de la Reforma from the old city center (Centro Histórico) through several office submarkets referred to as Reforma, Polanco, Lomas, Bosques de las Lomas, and Santa Fé. This corridor houses the majority of national and international corporate headquarters in the city, as well as most of its branded, full-service hotels. The second axis, which extends south from Centro Histórico, includes the Insurgentes and Perisur submarkets. Office hubs and a diverse, albeit smaller, supply of hotel assets are spread along this axis.

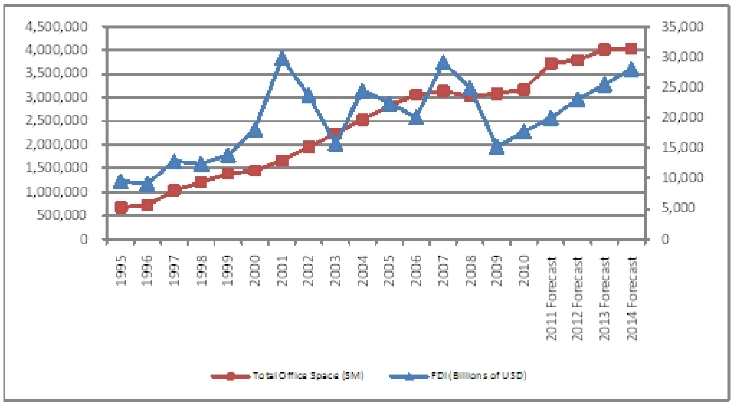
As of the third quarter of 2010, the Reforma to Santa Fé corridor housed 2.3 million square meters of Class A office space, equivalent to 76% of all Class A office space in Mexico City.

Map of Mexico City Office Submarkets Along or Near the Reforma-Santa Fé Corridor

More foreign direct investment in Mexico has corresponded to an increase in office space, led by industrial growth in northern and central Mexico and a growing corporate presence in Mexico City. Approximately 951,000 square meters of office space were under construction in Mexico City as of the third quarter of 2010.[2] This represents 30% of the existing supply of the city's Class A office space.

The following chart illustrates the relationship between foreign direct investment and available office space in Mexico City since 1995, along with forecasts for 2010 through 2014.[3]

Figure 3 Mexico City Available Office Space and Foreign Direct Investment



Source: Secretary of the Economy, CBRE, ECLAC, and HVS

A More Detailed Review of the Reforma Submarket

Government initiatives and incentives to redevelop Paseo de la Reforma (the main roadway along the Reforma to Santa Fé corridor) have kindled interest among private real estate developers. Approximately 48% of the office space under construction in the city (457,000 square meters) will be located along Paseo de la Reforma from the area known as La Alameda Central near the Centro Histórico to the intersection of Paseo de la Reforma with Avenida Mariano Escobedo. Within this same 3.5-kilometer corridor, an additional 231,000 square meters of office space have been proposed.

The amount of Class A office space under construction represents a 192% increase in supply over current 237,321 square meters in the Reforma district. The addition of office space proposed (i.e., not yet under construction) for this district would swell the rise to 290%. Since 1995, Mexico City has absorbed an average of approximately 171,000 square meters of Class A office space annually. The forecasted increase of 951,000 square meters for the entire Mexico City area over the next five years should be largely absorbed as new businesses seek space in the city. Expected increases in supply should keep rental rates relatively stable in this market.

Figure 4 lists major office developments proposed for the Reforma submarket, and Figure 5 maps their locations.

Figure 4 Proposed Commercial Developments on Paseo de la Reforma

	Development	Total Office Space SM	Total Office Space SF	Status	Delivery
A	Senate	34,000	365,973	Under Construction	02Q2011
B	Capital Reforma	30,000	322,917	Under Construction	02Q2012
C	Corporativo Santander	220,000	2,368,058	Under Construction	01Q2013
D	Punta Reforma (Axis)	40,630	437,337	Under Construction	01Q2013
E	Torre del Angel (342/Florencia)	38,055	409,620	Under Construction	02Q2012
F	Corporativo BBVA Bancomer	50,000	538,195	Under Construction	02Q2013
G	Torre Reforma	44,297	476,808	Under Construction	02Q2013
H	Torre Matrix	15,308	164,774	Proposed	01Q2013
I	Insurgentes Y Villalogin	50,000	538,195	Proposed	01Q2013
J	Torre Diana	63,000	678,126	Proposed	02Q2013
K	Torre Cine Latino	-	-	Proposed	03Q2013
L	Puerta Reforma	59,710	642,712	Proposed	01Q2013
M	Reforma 243	28,212	303,671	Proposed	01Q2013
N	Reforma 509	15,000	161,459	Proposed	02Q2013

Figure 5 Map of Proposed Commercial Developments[5]

Map Source: Google Earth

Hotel Supply and Demand

Occupancy for hotels along Mexico City's Reforma to Santa Fé Corridor has been relatively stable over the past 15 years, with the exception of the drop in 2009 caused by the effects of the recent recession and the H1N1 scare. Moreover, there is a strong correlation between the absorption of new hotel rooms and the increase in foreign direct investment and office inventory.

Lodging demand began to strengthen in September of 2009 and continued to improve into 2010. Lodging data for hotels along the Paseo de la Reforma corridor are presented in Figure 6 below.

Figure 6 Historical Lodging Trend – Primary Mexico City Hotels – Reforma to Santa Fé Corridor

	Number of Branded Hotels	Available Room Nights	Occupied Room Nights	Occupancy
1994	19	2,315,560	1,515,917	65%
1995	20	2,390,377	1,233,921	52%
1996	22	2,571,207	1,478,955	58%
1997	22	2,678,735	1,576,389	59%
1998	23	2,698,055	1,576,028	58%
1999	23	2,717,060	1,633,306	60%
2000	23	2,718,966	1,668,461	61%
2001	24	2,753,440	1,631,712	59%
2002	26	2,838,720	1,756,304	62%
2003	29	3,161,564	1,918,867	61%
2004	29	3,249,921	1,990,458	61%
2005	30	3,255,055	2,103,290	65%
2006	32	3,282,735	2,030,129	62%
2007	34	3,418,680	2,095,455	61%
2008	37	3,521,937	2,198,536	62%
2009	41	3,762,141	1,835,240	49%
2010	43	3,958,146	2,295,725	58%

These figures represent a very stable hotel market. The table above also illustrates that, since 1994, the corridor has absorbed an average of 48,000 room nights annually. Limited supply is expected throughout the city, which should aid the recovery of existing hotels. New supply anticipated for the Reforma and Santa Fé submarkets includes a 150-room Park Hyatt (currently on hold), a W Hotel (scheduled to open in 2013), and a Marriott Edition (expected to open mid-year 2011).

The Polanco hotel district has long been considered an especially attractive location given its proximity to prime office markets in the Lomas, Polanco, and Reforma submarkets. New hotels have come online in recent years to service demand created by the maturing Bosques de las Lomas and Santa Fé submarkets, which now house many commercial and financial headquarters.

During the 1990s, as hotel corridors spread from the city center toward the western suburbs, the Reforma to Santa Fé corridor seemed stalled. But the area provides a rare opportunity for development in one of the densest parts of Mexico City, where sites zoned for hotel development have become very hard to find. The corridor's access to extensive public transportation, along with government revitalization efforts, has also encouraged new investments.

Most development in the Reforma to Santa Fé corridor centers on high-end office and residential projects, with few sites dedicated to the construction of hotel assets, whether free-standing or within mixed-use projects. In the mid-term, we expect the corridor's lodging demand base to expand, allowing for existing hotels to achieve higher occupancy and command higher rates as proposed supply stabilizes. Local and federal tourism authorities continue to promote leisure visitation to Mexico City both nationally and abroad, which has the potential to bolster weekend occupancy in a hotel market historically dominated by weeknights. At the same time, the staggered delivery of new commercial developments over the next five years should further strengthen weekend demand, especially during peak seasons. Average rates should see a gradual rise with the concentration of higher-rated commercial demand.

Wrap-up

The Mexico City office and lodging market is in the midst of a renaissance. As foreign direct investment is forecast to continue to increase in Mexico, broader real estate development in the local market should benefit existing and future hotels in Mexico City. This factor, coupled with limited increases of hotel supply, should result in improving occupancies and average rates for area hotels, perhaps exceeding levels achieved prior to the economic recession of 2008/09.

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[1] Mexico's Secretary of the Economy Press Room http://www.economia.gob.mx/swb/en/economia/p_Sala_de_Prensa (February 2011)

[2] Datatur

[3] CBRE 3rd Quarter 2010 *MarketView* office market report.

[4] Forecasts for FDI were provided by the Mexican Secretary of the Economy for 2010 and reflect an estimated recovery to top historical levels through 2014.

[5] Delineations on the map that are not labeled with a letter depict residential developments, which we have not detailed in this report.

About Luigi Major, MAI

Luigi Major, MAI, is Managing Director, Advisory of HVS Americas. A trusted advisor, he serves clients across the Americas to deliver tailored solutions to meet their needs, leveraging the breadth of HVS resources and expertise. He has participated in thousands of assignments throughout the United States, Latin America, and the Caribbean. Luigi earned his bachelor's degree from the University of Houston's Conrad N. Hilton College of Global Hospitality Leadership and joined HVS in 2007. Contact Luigi at (310) 270-3240 or .

About Raul Duarte

Raul Duarte, a Senior Project Manager with HVS Mexico City, has been consulting in the hospitality industry for over ten years. He began as an analyst at Grupo Inmobiliario Inova and remained part of the platform through subsequent phases as Insignia/ESG and following the company's acquisition by CB Richard Ellis. During his career in the real estate industry, Raul has undertaken varied engagements throughout Mexico. He has prepared analyses and designed financial models for complex, multi-component and multi-phase transactions and development programs. He has completed market and feasibility studies for office, industrial, retail, hotel, and residential projects. He has lent varied and active support in distressed debt and asset valuation and acquisition programs. He has also participated in marketing of investment programs, with a particular focus on the housing sector. While with CB Richard Ellis, Raul formed and was Associate Director of Multi-Housing Services, a division designed to satisfy the real estate requirements of housing development groups. As part of this initiative, he completed transactions with a collective value of US$60 million.

About Richard J. Katzman

Richard Katzman is Senior Managing Partner for the LATAM region. He established the HVS Mexico City office in 2007. He has been active in Mexico and other Latin America countries since 1992. During this period, Richard formed Grupo Inmobiliario Inova, a real estate advisory boutique that merged in 2001 with Insignia/ESG, then among the most prominent real estate service companies in the world. In 2003, following the merger between Insignia/ESG and CB Richard Ellis, Richard elected to reestablish an independent platform prior to joining HVS in 2007. Richard was born and raised in Mexico City. He completed his undergraduate studies at Cornell University, School of Hotel Administration, and received his MBA from The Wharton School. He is fluent in English, Spanish, French, and Portuguese. Contact Richard at +52 (55) 5245-7590 or .