Go South, Young Men (and Women…)

Key Investment Considerations in Latin America

BY JAMES M. WHITTINGTON, CRE®, FRICS

"GO WEST, YOUNG MAN" WAS WISE ADVICE from Horace Greeley in the mid-1800s and, in today's world, "Go South, young men" (and, of course, women), may be equally wise advice for real estate investors seeking attractive opportunities around the globe. While most investment capital remains focused on the United States, with sizeable amounts also allocated to Asia and Europe, many countries in Latin American offer attractive, and possibly less risky and more fundamentally sound, investment alternatives. The following article presents a brief synopsis of the key factors that investors should consider as they evaluate the potential opportunities that Latin America offers.

WHY LATIN AMERICA?

As most real estate professionals know, hundreds of billions of dollars have been raised to take advantage of the distressed environment that exists in the U.S. as a result of the recent global financial crisis. However, the reality is that most of the anticipated "opportunities" have never materialized, primarily due to the "pretend and extend" strategy adopted by the U.S. government and major financial institutions. Moreover, the reality is that as long as there is no meaningful private sector job growth, any "value-added" investments that require significant lease-up in order to produce appropriate risk-adjusted returns are likely to fail by not fulfilling the underwriting assumptions upon which they are based.

About the Author

James M. Whittington, CRE®, FRICS, *co-founder, Nove International LLC, Chicago, specializes in investment and development opportunities in various markets outside of the United States. Whittington's career in commercial real estate investment and development has focused on capital market transactions. Since 1975, he has closed more than $3 billion of sales, acquisitions and financings, working with both domestic and international investors. He is personally involved with all of the company's investments, developments and clients. and currently is working on projects in Chile, Colombia, Peru, Argentina, and the United States.*

Prior to founding Nove International, Whittington was an executive vice president and managing director of Finance and Investments for U.S. Equities Realty, a full-service commercial real estate firm headquartered in Chicago. During his 15-year tenure there, he completed a number of major transactions including the negotiation of a development joint venture between the Chicago Sun-Times *and Donald Trump, resulting in the Trump Tower Chicago, and a series of debt and equity financings totaling approximately $1 billion for Grand Plaza, a 1.4 million-square-foot mixed-use development located in Chicago.*

Whittington graduated magna cum laude *from the University of Notre Dame, and was elected to Beta Gamma Sigma (the National Honorary Business Fraternity) and to Beta Alpha Psi (the National Honorary Accounting Fraternity). He is a certified public accountant and a licensed real estate broker.*

Furthermore, other global investment targets such as China, India and Europe face significant threats to their economic stability because of high sovereign debt and/or other underlying factors. Alternatively, many countries in Latin America are supported by healthy fundamentals that will help grow and stabilize their economies over the next decade. These fundamentals include:

1) Growing middle classes fueling strong demand and job growth;
2) Abundant and largely undeveloped natural resources;
3) Financially strong national banking systems and institutions;
4) Positive foreign trade surpluses;
5) Inflation that is generally under control;
6) Generally stable (if not appreciating) currencies.

With Latin America as a major source of food, oil and minerals to the rest of the world, billions of dollars of capital continue to flow into this region, and the corresponding need for development of infrastructure and real estate will be fueled by these strong underlying fundamentals.

As investors consider Latin America as a possible investment target, it is important to understand that potential financial returns will be *relatively* attractive in comparison to the U.S. and other regions of the world. Any return expectations should be evaluated in the context of the relative risks and underlying fundamentals that each region and/or country presents in relation to alternative targets. Therefore, an investor should not expect a risk "premium" over what one might expect to achieve in the U.S. or elsewhere. Rather, the real "risk" is to continue to allocate investment capital to regions that historically have produced acceptable risk-adjusted returns, but may now be fundamentally unsound. On the other hand, no one should invest in Latin America because they expect higher returns by taking higher risks, but because the relative returns they might achieve will be more likely due to the stronger underlying fundamentals that exist there.

Investors from the U.S. and Europe also may discover that Latin America is an easier place to do business than more far-reaching countries such as China and India. While China and India collectively contain 2.5 billion people (more than 36 percent of the total global population), which naturally presents untold real estate development opportunities, the cultural differences and travel distances make realizing such opportunities extremely challenging. In contrast, most Latin American people share the same Western European heritage as U.S. and European investors, offering cultural similarities. Travel to the southern hemisphere does not require crossing as many time zones, and travel costs are dramatically lower. Furthermore, while speaking Spanish or Portuguese is desirable, it is not mandatory in order to conduct business, as a large majority of business people in Latin America speak English. Even so, since both are Romance languages, they are inherently easier to learn than Mandarin or Hindi.

BRAZIL? MEXICO? WHAT ABOUT THE REST OF LATIN AMERICA?

When the subject of Latin American real estate investment is raised, investors invariably respond: "Tell us about the deals we can find in Brazil and Mexico." While any prudent Latin American investment strategy should always begin with a consideration of these two major countries, ignoring the rest of Latin America would be shortsighted. Although Brazil has rightfully been one of the dominant success stories in recent years (it is currently the seventh largest global economy[1] and is projected to be the fifth largest within the next few years, surpassing both the United Kingdom and France), the stampeding investment "herd" has not only picked over the low-hanging fruit, but also gobbled up the best local partners that are essential to doing business in that country. Despite this, given the size of the country and its enormous growth potential, many attractive investment opportunities remain. But investors must be very cautious. The amount of red tape one encounters can be frustrating. Just forming a company and bringing in capital takes a great deal of perseverance by the investor.

In the case of Mexico, with its proximity to the U.S., the investment community has operated in that country for decades. However, proximity to the U.S. is a double-edged sword. On one hand, the easy travel distance and many cultural similarities provide significant benefits, but on the other hand, because of its dependency on the U.S. consumer market, Mexico is more directly affected by downturns in the U.S. economy. Unfortunately, the highly publicized drug war and border incidents have dramatically raised red flags in both the U.S. business and tourist communities, leading many investors to think twice about investing there at the present time.

COUNTRIES OFFERING THE BEST POTENTIAL

Of all the remaining countries in Latin America, Colombia, Chile and Peru offer the best potential for

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Figure 1

Regional Country Facts

Country	Population (Global Rank)	Largest City (Population)	Other Cities with Pop. > 500,000	Main Exports	Per Capita Income (Global Rank)	Key Factors
Brazil	203M 5	São Paulo 19.6M	40	Cotton, sugar, gold, aluminum	$10,900 104	Projected to become world's 5th largest economy
Mexico	113M 11	Mexico City 19.3M	37	Manufactured goods, petroleum, silver, fruits, vegetables, coffee, cotton	$13,800 85	Issues with crime and drug trade
Colombia	45M 28	Bogotá 8.2M	8	Petroleum, coffee, coal, nickel, emeralds, apparel, bananas, cut flowers	$9,800 112	Rapidly growing middle class with need for new housing stock and retail supplies
Argentina	42M 31	Buenos Aires 12.9M	9	Soybeans, petroleum, vehicles, corn, wheat	$14,700 76	Political and legal system challenges
Peru	29M 41	Lima 8.7M	3	Copper, gold, zinc, tin, iron ore, molybdenum, petroleum products, natural gas, coffee, vegetables, fruit, textiles	$9,200 115	Latin America's fastest growing economy
Venezuela	28M 42	Caracas 3M	6	Petroleum, minerals, chemicals, agricultural products	$12,600 92	Political challenges – "the Chavez factor"
Chile	17M 60	Santiago 5.4M	2	Copper, fruit, fish products, paper and pulp, chemicals, wine	$15,500 72	More evolved financial market – closer to U.S. model than other Latin American countries
Ecuador	15M 68	Guayaquil 2.6M	1	Petroleum, bananas, shrimp, cacao, coffee, hemp, wood, fish	$8,000 123	Termination of bilateral investment treaties in 2009 has generated economic uncertainty and discouraged investment
Bolivia	10M 80	La Paz 1.6M	3	Natural gas, soybeans and soy products, crude petroleum, zinc ore, tin	$4,800 150	Political challenges (similar Marxist/socialist government as in Venezuela)
Paraguay	6M 105	Asunción 1.9M	0	Soybeans, feed, cotton, meat, edible oils, electricity, wood, leather	$4,900 149	High unemployment forcing immigration to neighboring countries
Costa Rica	5M 120	San José 1.4M	0	Bananas, pineapples, coffee, melons, ornamental plants, sugar, beef, seafood, electronic components, medical equipment	$11,400 84	Alternative resort/vacation home destination to Mexico and Caribbean
Panama	3M 133	Panama City 1.3M	0	Bananas, shrimp, sugar, coffee, clothing	$12,700 91	No currency exchange issues (balboa/dollar are used interchangeably)
Uruguay	3M 134	Montevideo 1.6M	0	Beef, soybeans, cellulose, rice, wheat, wood, dairy products, wool	$14,300 82	The "Switzerland" of Latin America – advantageous international banking laws

Source: The World Fact Book, CIA, Nove International strong economic growth and investment opportunities. Many well-known experts agree, as indicated by the following quotes:

> *[Sam] Zell thinks the Latin American real estate boom is in its early stages.… [He believes that] the middle class will continue to create growing demand … His … private investment firm has put about $1.5 billion into international markets, including Brazil, Mexico, Colombia, Peru, Chile.*
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> *Forbes,* February 14, 2011

> *Investors see political stability in countries like Chile, Brazil, Mexico, Colombia and Peru, strong domestic demand and expanding credit. We are seeing unprecedented interest in the region.*
>
> *The Wall Street Journal,* March 21, 2011

> *We are also optimistic on growth in Latin America and are prepared to increase our investment there… Brazil is fast growing, but Chile, Colombia are also providing interesting opportunities for private equity investors.*
>
> Jin Liqun, chairman of the China Investment Corp., March 30, 2011

Colombia

Not long ago the mere mention of Colombia would conjure up visions of drug trafficking, bombs and terrorist kidnappings. However, after eight years of stable governance by the Alvaro Uribe administration, 2002–2010, Colombia has been dramatically transformed. In many respects, it is a much safer place to visit than many other favored investment markets (three of its largest cities—Bogota, Medellin and Cartagena—have lower homicide rates than Washington, D.C.[2]). No wonder tourism is booming along with the rest of its economy.

As the third-largest country in Latin America with a population of almost 45 million (only Brazil and Mexico are larger), Colombia possesses a highly educated workforce and a rapidly growing middle class, providing great opportunities for retail and residential development. Rich in fertile farmland with a temperate 12-month growing season, it is the second-largest producer of coffee and fresh flowers in the world. With largely untapped natural resources (including a recent major petroleum discovery), 37 international mining companies established operations in Colombia in 2010 alone.

Colombia is strategically located in the center of the Americas. Situated directly south of the Panama Canal, with major coastlines on both the Atlantic and Pacific, it is ideally placed to serve as a major logistics/distribution point for South America. Colombia also enjoys being in a hurricane-free zone, and is rapidly becoming a major shipping and cruise line destination. Flying north or south is also easier, as most destinations are no more than about six hours in either direction.

With nine cities having more than 500,000 residents, its population is spread over the entire country, offering development opportunities across several markets. Given all of its positives, it is not surprising that Colombia recently has been awarded investment grade status by Moody's, Standard & Poor's and Fitch. Colombia was also recently named by *The Economist* as one of the strongest emerging markets in the world (it is the "C" in CIVETS, a new group of emerging countries expected to soon rival the BRICs. The former group is composed of Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa; the latter is Brazil, Russia, India and China.) Now that the free trade agreement with the U.S. has been executed, Colombia will no longer be the best-kept secret in Latin America.

Chile

For the past two decades Chile has been a favored market of the international investment community. Chile maintains the lowest country risk in Latin America because of its economic stability, monetary discipline and a balanced political and fiscal environment. Its capital markets are highly sophisticated and are more similar to the U.S. than any other country in Latin America. As a result, it ranks 11th on the Global Economic Freedom Index, 19th on the Business Environment Index, and 31st on the Competitiveness Index. Its people are hard working, highly efficient, and known for their honesty (it ranks 21st on the Corruption Perception Index). The sources for these global index rankings have been compiled by several different respected global organizations, including The World Bank[3], World Economic Forum[4] and The Heritage Foundation.[5]

With a climate and terrain much like California, its fertile agricultural lands make it a major source of food for the entire world (avocados, fruit and wine are just some of its major exports). Chile also is a top exporter of fish (e.g., salmon and sea bass) and minerals (copper among them).

With all of its positive factors, Chile's main challenge is its size. With fewer than 17 million people, and only three cities with more than 500,000 residents—Santiago, Valparaiso and Concepción—investors just can't find enough projects to invest in.

Peru

Like Colombia, Peru is another country that has enjoyed dramatic positive economic development in recent years. In fact, its economy has grown more than any other Latin American country over the past ten years (more than 144 percent from 2000–2009, and an estimated nine percent in 2010[6]). Over the same time span, it has also benefited from the lowest inflation rate, averaging only 2.2 percent annually.[7] Peru is an open trading partner, with recent free trade agreements with the U.S. and the EU, along with long-standing agreements with China, Canada, Korea and Singapore. It continues to encourage direct foreign investment by offering attractive tax incentives and tax stability agreements.

Peru is the second-largest fishing exporter in the entire world and the third-largest mining country. China has been a major investor, pouring billions into the country to purchase gold, copper and other minerals, and this capital has helped fuel Peru's growth. It is also a major food supplier to the world, as it also enjoys a temperate climate and 12-month growing season. In addition, a soon-to-be-completed water tunnel through the Andes will connect the Amazon River Basin with a vast tract of semi-arid land in the northern region, which will substantially increase the country's agricultural capacity.

Peru has the same investment grade ratings as Brazil, so its economic prospects should remain high for decades to come. However, after many years of stable democratic government, a socialist regime recently took office. As a result, many investors are taking a wait-and-see attitude before undertaking any major new projects.

COUNTRIES WITH CHALLENGES

Argentina

Of all the countries in Latin America, Argentina is the most frustrating. Blessed with rich natural resources, vast agricultural lands and a highly educated and sophisticated work force, it sadly is its own worst enemy. At one point in the early 1900s, it actually had one of the largest economies in the world, and rivaled the U.S. in many respects. However, its well-known political instability in the latter half of the 20th century, which has continued up to the present time, has held it back from reaching its full potential. This instability is highlighted by its government actions during its financial crisis in 2001, when it refused to enforce international contractual laws, resulting in billions of dollars of losses suffered by foreign investors. While foreign tourists still enjoy the beauty and cultural richness of Buenos Aires (the "Paris of Latin America"), most foreign investors remain wary of making any meaningful financial commitments to Argentina. Although it is currently experiencing strong economic growth (9.3 percent in 2010 and an estimated 8 percent for 2011[8]), long-term prospects remain challenging due to political issues facing foreign investors.

Venezuela

The investment prospects in Venezuela can be summarized in three words: "the Chavez factor." As one of the largest petroleum exporters over the past 50 years, Venezuela still has a higher per capita income than most other Latin American countries. However, the leftist socialist Chavez government has dramatically curtailed its economic prospects, and many large multi-national companies have left the country. Although companies can continue to operate profitably there, it is extremely difficult to get capital out of the country. This dire situation is most clearly illustrated by two recent World Bank[9] rankings of Venezuela—out of 183 countries in the world, it is currently ranked 172 in Business Friendliness and 179 in Investor Protection.

Bolivia

Like Venezuela, Bolivia is controlled by a leftist socialist government that severely restricts the economic activities of the private sector. Like many other Latin American countries, it is rich in undeveloped natural resources, especially natural gas. However, the government has not enforced international contractual laws, most recently reflected in its failure to fulfill international natural gas contracts. Of all the countries discussed herein, Bolivia is one of the poorest.

THE SMALLER COUNTRIES

Uruguay

With its proximity to Argentina (Montevideo is only a short boat ride across the Rio de la Plata from Buenos Aires), Uruguay is culturally very similar to Argentina. Known as the "Switzerland of Latin America" because of its attractive banking laws, it has also encouraged foreign investment by enacting many free trade zones. Punta del Este, an oceanfront resort destination, has become an international playground of sorts. However, with a population of only 3.3 million residents, half of which live in Montevideo, the country's size limits any meaningful investment opportunities.

Paraguay

Paraguay has twice the population of Uruguay, but is a very poor country with per capita income of only $4,900. While its economy grew 15.3 percent last year, the highest growth rate in all of Latin America, that figure is off of a very low base.[10] Despite agricultural exports like soybeans and cotton, its main export is its people, who migrate to other countries seeking work because of high unemployment and lack of economic opportunities there.

Ecuador

Ecuador, with a population of more than 15 million, is substantially dependent on its petroleum resources. Other major exports include bananas, shrimp and cacao, but the country terminated 13 bilateral investment treaties in 2009, generating economic uncertainty and discouraging private investment. On a positive note, Quito is currently ranked as one of the top retirement destinations in the world, primarily because of its low cost of living and temperate climate.

Costa Rica

Over the past 10 years Costa Rica has become an attractive alternative to Mexico and the Caribbean for vacation homes and retirement. The short travel distance and good weather have helped foster this, and medical tourism has also spurred some economic activity. But besides typical agricultural exports like fruit and coffee, there is no real industry to generate significant investment opportunities.

Panama

Panama also has become an attractive retirement home destination for U.S. expatriates because of its good weather, low cost of living and use of the U.S. dollar as its daily currency, as opposed to the balboa, the official currency. It also will benefit from the widening of the canal, which is scheduled for completion in 2014. However, it is currently hampered by overbuilding in the residential and hotel sectors.

OTHER COUNTRIES

There are many more countries in both Central and South America, such as Guatemala, Nicaragua, Belize, Honduras, etc., but they all are essentially non-factors from an institutional investment standpoint.

CONCLUSION

Latin America is a region of the world that has been ignored for too long. With its abundant natural resources and burgeoning middle class, it will continue to grow as a formidable economic force. With its vast agricultural capacity, it is poised to become the bread basket for the world. Just as the western frontier of the U.S. provided unlimited economic opportunity in the latter half of the 19th century, the fundamental building blocks are in place in Latin America to offer the same to real estate investors, developers and practitioners alike. As they say in Spanish, "Hombres y mujeres jovenes, su futuro les espera en el Sur!" (Young men and women, your future awaits in the South!) ■

ENDNOTES

1. World Economic Outlook Database, April 2011, *http://www.imf.org/external/ns/cs.aspx?id=28*.
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3. International Finance Corporation and The World Bank, "Doing Business 2011," *http://www.doingbusiness.org/reports/global-reports/doing-business-2011*.
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5. The Heritage Foundation and *The Wall Street Journal,* "Index of Economic Freedom 2011," *http://www.heritage.org/index/ranking*.
6. World Economic Outlook Database, op. cit.
7. International Monetary Fund, 2011, *World Economic Outlook,* "Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows," p. 78, *http://www.imf.org/external/pubs/ft/weo/2011/01/*.
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10. International Monetary Fund, op. cit. *http://www.imf.org/external/pubs/ft/weo/2011/01/*.