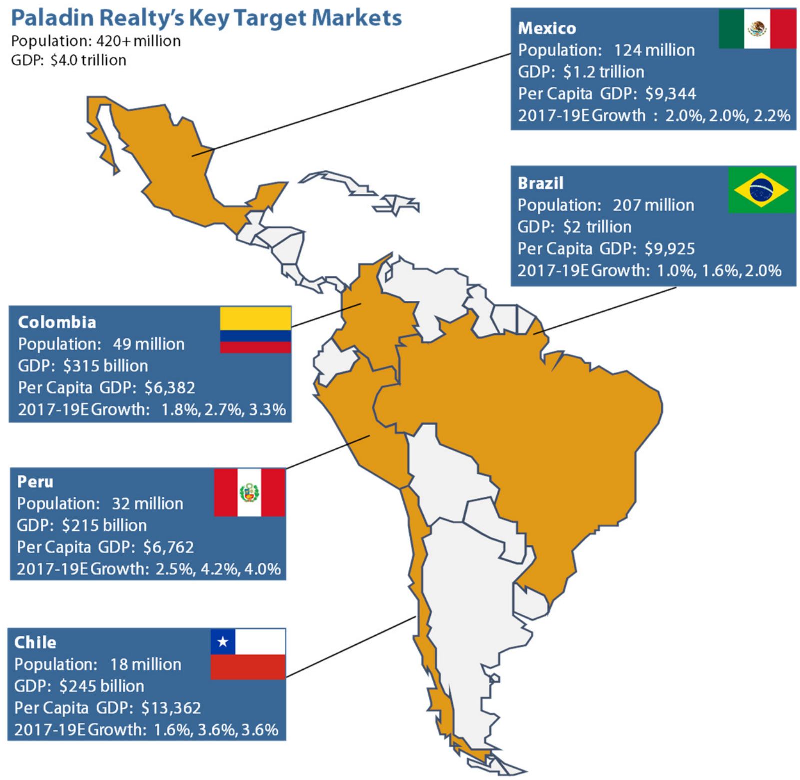
Latin America Research:
2019 Outlook – Macro & Property Trends

January 2019

Executive Summary

- Latin America's leading economies of Brazil, Mexico, Colombia, Peru and Chile continue to benefit from a convergence of long-term demographic, economic and political trends that are expected to support sustainable growth over the next several years.
- These positive long-term trends include attractive demographics, a growing middle-class, greater mortgage availability and large housing deficits, all factors which should continue to result in resilient demand for housing and the development of other real estate products.
- Political risk has receded in the region as newly elected market-friendly leaders prevail in Brazil, Colombia and Peru; some uncertainty remains in Mexico with questionable initial policies of its new President.
- Brazil's economic and political outlook improved sharply in 2018 with the election of a pro-business President, who is already pursing a reform agenda. GDP is expected to grow in the 2%+ range in 2019 and beyond.



Sources: Morgan Stanley, Itau, IMF, Bloomberg, Paladin Research ($ amounts above are in USD)

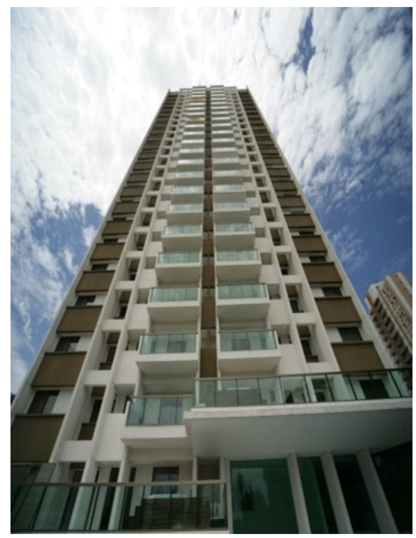
- Mexico and the three leading countries of the Andean region (Colombia, Peru and Chile) are each poised to grow 2-4% in 2019 and beyond, with economies increasingly driven by domestic consumption and intraregional trade. In Mexico, while the conclusion of NAFTA renegotiations in 2018 removed some uncertainty, the new President's early actions have given mixed messages at best and Paladin remains cautious on Mexico until the new President's policies become more clear and constructive.
- In some markets, most notably in Brazil, real estate assets are trading below historical values due to a combination of slower growth, oversupply of certain commercial property types, and a chronic dearth of debt and equity capital, creating attractive investment opportunities in select sectors.
- Local currencies have stabilized near decades' lows relative to the U.S. dollar, which should stimulate trade and investment, and which now represent an attractive entry point for investors.
- Paladin Realty believes the region offers global institutional investors a compelling portfolio diversification opportunity with scale, superior investment-level economics (high profit margins, low leverage), and highly visible and resilient demand drivers.

1998-2018: Latin America's Emergence as an Institutional Market

Over the past two decades, the thesis for Latin America real estate investment has undergone a dramatic transformation. When Paladin Realty first began investing in the region in the late 1990s, many markets were plagued by weak construction standards, poor infrastructure and limited institutional sources of capital. Institutional-quality local operating partners were hard to come by, as was reliable market data. Further, while the region's scale and attractive demographics offered the promise of superior economic gains, the structural reforms needed to unlock the region's long-term growth potential were still in the early stage of being realized. In short, investing in Latin America in the early days required vision, patience and conviction of strategy.

Fast-forwarding twenty years later to 2019, Latin America has experienced two decades of growth that has lifted tens of millions of people out of poverty and into the middle-class, fueling demand for all types of goods, services and modern real estate, in particular housing. Generally prudent monetary and fiscal policies, combined with widespread reforms and public investment in the areas of energy, trade, telecommunications, infrastructure and labor, have all contributed in varying degrees to the region's economic expansion of the past two decades. Each of Paladin Realty's target markets has earned investment-grade ratings (including Brazil, which was subsequently downgraded in late 2015 due to its deep recession). Combined with the scale of these markets – over 400 million people, a larger market than the United States – these factors have attracted billions of dollars of foreign investment capital to the region. Modern institutional-quality office, retail, industrial and hotel developments have changed the face of Latin America's major metropolitan areas, while new low and middle-income housing projects have been developed in an attempt to solve the region's large housing deficit, which is estimated to be over 18 million units in Paladin Realty's target markets.[1] Along the way, many small family-owned development companies have grown into large sophisticated local real estate players in an industry that has become much more professional in all respects, supported in part by government housing finance programs and greater access to mortgages.

Why Latin America?



Despite slower growth and challenging headwinds in recent years, Brazil, Mexico and the Andean countries of Colombia, Peru and Chile continue to benefit from a convergence of long-term demographic, economic and political trends that are expected to support sustainable growth in demand for housing and other modern real estate product for many years into the future.

These long-term trends supporting real estate investment in the region include:

- Favorable demographic tailwinds as young and growing populations across the region enter the workforce. Demographically, Latin America today resembles the United States in the 1960s and 1970s, as its "baby boomers" entered the workforce fueling decades of economic growth and wealth creation.
- Sustainable long-term real estate demand drivers fueled by demographics and two decades of pro-growth economic, fiscal and monetary policies. The region was relatively resilient during the 2008-2009 Global Financial Crisis due to well-capitalized banking systems, large foreign exchange reserves, flexible exchange rates and prudent fiscal policies. While GDP growth for the region has moderated since, the three Andean countries and Mexico are expected to show sustainable growth potential in the 2% to 4% range for the next several years, and Brazil is expected to grow 2%+ in 2019 and beyond.[2] Latin America continues to represent one of the better performing regions in the world in terms of growth potential.
- Increasing affluence over the long term, as personal wealth and incomes rise with productivity gains and economic growth. In the decade following 2002, over 40 million people entered Brazil's middle-class.[3] A similar story is now playing out in Mexico, Colombia, Peru and Chile with a combined population of 200 million that is comparable in size to Brazil. Rising prosperity and growth, in turn, are fueling demand for all types of goods, services and modern real estate, especially housing.
- Greater housing affordability for millions of potential new homebuyers as compared to a decade ago due to increased availability of long-term (30+ year) mortgages. In each of Paladin's target markets, governments have made the expansion of mortgage markets a major priority over the past decade, enacting various programs to encourage the growth of mortgage financing both from private banks and the public sector.
- Favorable supply/demand imbalance for low- and middle-income residential housing. There is an estimated housing deficit of

[1] JP Morgan Brazil Real Estate 101, April 2018; BBVA; Softec; Peru Ministry of Housing.
[2] Paladin Research.
[3] Veja Avanço da nova classe média prossegue, diz especialista August 2012.

more than 18 million units in Paladin Realty's four main target markets of Brazil, Mexico, Colombia and Peru due to a chronic shortage of capital to create adequate supply, a supply level which has not even been able to match new annual household formation let alone solve the much larger existing housing shortage, with potential demand exceeding new supply by 2-7x in recent years.[4]

- Favorable environment for foreign investors characterized by prudent monetary and fiscal policy, unrestricted capital flows, the rule of law, and increasing respect for property rights, contracts, and due process.

Superior Project-Level Economics

Most importantly, because of the region's under-developed capital markets, with limited debt for real estate and relatively low penetration of private equity capital, Latin America offers some of the most attractive project-level economics for real estate investments in the world today. Profit margins for real estate investments in Latin America are typically substantially higher than comparable investments in the developed economies of the United States, Europe or Asia. For example, Paladin Realty has historically targeted 15-25% profit margins on its for-sale housing investments and 250-500 basis points of development profit (i.e., the difference between the unleveraged stabilized return on cost and exit cap rates) for commercial properties in times where supply and demand factors justify new development. Higher profit margins enable investors to target opportunistic returns in the region with a fraction of the debt utilized by the typical opportunity fund in the more developed economies, thus reducing risk. Commercial properties are typically acquired or developed on an all-equity basis, while residential investments utilize low leverage, typically in the range of zero to 40% of total projected cost depending on the country. Importantly, mortgage financing is readily available to homebuyers in each of Paladin Realty's target markets, with terms of 30+ years and interest rates in the 6-12% range depending on the type of buyer.

With assets priced to near perfection in the United States and other developed markets, Paladin Realty believes the prospect of a high return, low leverage strategy with solid underlying demand fundamentals offered by Latin America should be quite persuasive for global institutional investors seeking growth and diversification without the increased risk that comes from more aggressive underwriting and higher amounts of debt required in developed markets to "make the numbers work".

Looking Past the Headlines: Is Now the Right Time to Invest?

Given the region's attractive demographics and increasingly prudent policy decisions, Paladin Realty believes Latin America clearly represents a long-term growth opportunity. Nonetheless, a key question regarding any new investment is timing.

Headlines about Latin America in general over the past few years have certainly raised caution amongst global investors, particularly those that are U.S. dollar based. Local currencies fell against the U.S. dollar by as much as 50-70% during 2014-16 due to declining commodities prices as China's economy cooled, the prospect of rising U.S. interest rates and protectionist policies, as well as recent political and economic uncertainties, particularly in Brazil and Mexico. Efforts to reform and grow Argentina's economy have stalled. Venezuela's desperate population has begun to flee from the collapse of its economy caused by its leaders' gross mismanagement of its many resources.

A natural reaction by many investors in the wake of such negative headlines is to retreat by assuming the trends of the recent past will continue long into the future. However, when one instead looks at the fundamentals, there are several important indications that Paladin Realty's target markets are poised for sustainable growth in 2019 and beyond. Indeed, Paladin Realty believes the next several years should prove to be an optimal time to deploy investment capital in the region for astute real estate investors.

Paladin Realty has a constructive outlook on the region over the next several years for the following reasons:

- Brazil's economic and political outlook has improved dramatically in 2018. Consumer and business confidence are up with the election of President Bolsonaro who is pursuing an anti-corruption and pro-business agenda. Brazil's economic recovery appears well-rooted with growth expected to be in the 2%+ range in 2019 and beyond.[5] The recent *Lava Jato* ("car wash") corruption probe has landed dozens of politicians and business leaders in jail, which will serve to strengthen the country's institutions and corporate culture in the years to come.

- Mexico and the Andean countries of Colombia, Peru and Chile are poised for sustainable growth with economies increasingly

[4] JP Morgan Brazil Real Estate 101, April 2018; BBVA; Softec; Peru Ministry of Housing.
[5] Banco Central do Brasil, Inflation Report September 2018.

driven by domestic consumption and intraregional trade through the Pacific Alliance and other trade pacts, such as the renegotiated NAFTA agreement.

- Reduced inflationary pressures are allowing central banks to lower interest rates, further stimulating growth. For example, Brazil's central bank has cut interest rates by 775 bp since 2015 to 6.5% today.[6] Brazil's inflation has declined from 10.7% in 2015 to 4.4% in 2018.[7] Interest rates and inflation in Mexico and these Andean countries remain in the low single digits.
- Local currencies have stabilized near decades' lows in real terms, which should stimulate trade and investment, and which represent an attractive entry point for U.S. dollar-based investors.
- Commercial real estate assets in some markets are trading below historical values due to a combination of slower growth and oversupply, creating attractive investment opportunities in certain sectors.
- Long-term growth trends remain intact including attractive demographics, a growing middle-class, greater access to credit, and large housing deficits, which should continue to fuel demand for new housing and other modern real estate.

Pacific Alliance Countries are Poised for Growth

Positive Economic Outlook for Colombia, Peru and Chile; Mexico's Near-Term Outlook More Uncertain

The case for sustained economic expansion is quite strong in the leading Andean countries of Colombia, Peru and Chile, as well as Mexico. Paladin Realty maintains a positive investment outlook in all four countries, albeit more cautiously with respect to Mexico. Collectively, these countries account for roughly half of the population, GDP and overall stock market capitalization of Paladin's target markets in Latin America.[8] Fueled by demographic tailwinds and a population totaling more than 200 million, these four countries are forecasted to expand in the 2% to 4% range in 2019 and beyond in real terms.[9] Growth in these markets represents a slowdown from the boom years of the commodities super-cycle (2004-2014), but is still strong from a global perspective and is generally trending in a positive direction. Paladin Realty is more cautious on Mexico until the new President's policies become more known and constructive.

Stable Drivers of Long-Term Growth

Three of the most important drivers of economic growth for any country are (1) low inflation, (2) fiscal balance, and (3) free trade. The outlook on all these fronts for Mexico, Chile, Peru and Colombia remains generally positive. Inflationary pressures have eased in each of these countries to between 2% and 5% today, well within central bank target ranges.[10] Stable prices permit companies and households to execute on longer term planning and investment decisions. Further, a balanced budget helps keep sovereign debt levels under control. Most emerging market crises occur due to a sovereign credit event, which is essentially the accumulation of fiscal deficits. As such, the relatively manageable fiscal balances in each of these countries is an added source of resilience and helps keep government balance sheets in a solid position. While the decline in global commodity prices has put government spending under pressure due to reduced tax receipts and partially contributed to the slowdown of the region's economies, Paladin Realty believes a less bullish commodity pricing environment has largely been priced into today's markets. Relatively low sovereign debt balances and substantial central bank reserves helped provide Paladin Realty's target countries resilience as each made necessary fiscal adjustments.

The Pacific Alliance – Free Trade Stimulating Growth

Mexico, Colombia, Peru and Chile have clearly embraced the third driver of growth, free trade, in forming the Pacific Alliance to promote trade among its members and with the rest of the world. Free trade is an important driver of economic growth as it helps support employment and creates an incentive for local businesses to become more competitive globally through increased productivity. Collectively, the economies of these Andean countries and Mexico represent the sixth largest economy in the world

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[6] Banco Central do Brasil.
[7] Banco Central do Brasil, Inflation Report September 2018.
[8] IMF World Economic Outlook Database October 2015; World Bank; & Bloomberg Data.
[9] Paladin Research.
[10] Ibid.

as measured on a purchasing power parity basis, with a combined GDP of US$3 trillion.[11] Each member of the Pacific Alliance has a free trade agreement with the United States, as well as many other countries in the world. In addition to trade, the Pacific Alliance has created an integrated stock exchange and has promoted visa-free movement of its citizens among member countries. While the dollar volume of trade has dropped in line with recent declines in commodity prices, affecting both currencies and budgets, these countries are low-cost producers and continue to export all the physical volumes they produce, supporting employment. Further, while Brazil has historically been a relatively closed economy, its newly elected President is now pursuing free trade policies and seeking for Brazil to also join the Pacific Alliance.

Improved Political Visibility

Mexico, Colombia and Peru each saw new Presidents take office in 2018. In Colombia, President Iván Duque was elected to a four-year term in a June 2018 run-off election. His pro-business agenda is focused on improving the FARC peace agreement, fighting corruption, harsher penalties for drug traffickers, and a continued commitment to orthodox macro policies including infrastructure investment, tax reform and deregulation. While there may be strong disagreements surrounding the controversial peace process and the appropriate way for the country to move beyond past decades of conflict, Paladin Realty maintains that the pillars of Colombia's macro stability (i.e., low inflation, healthy sovereign balance sheet and pursuance of free trade) remain solidly in place.

In Peru, President Martin Vizcarra assumed office in March 2018 after the early departure of former President Pedro Pablo Kuzcinski (PPK) amidst corruption allegations. Since taking office, Vizcarra has continued PPK's pro-business policies, has improved relations with congress, and has seen an uptick in the economy supported by investment and private consumption. Peru has among the strongest fundamentals of any country in Latin America with an investment grade rating, balanced budget, significant external debt reduction over the past decade, well-managed inflation, and preferred status as a low-cost producer of commodities. The story of rising prosperity has greatly benefited Peru, which has seen its poverty rate decline from 59% in 2004 to 21% today.[12]

In October 2018, Mexico elected Andres Manuel Lopez Obrador (AMLO) as its new President. While AMLO's victory has already raised some concerns within the business community (e.g., the decision to halt construction of Mexico City's new international airport based on a dubious referendum), Paladin Realty maintains a cautiously constructive outlook on Mexico for several reasons. First, the substantial reforms passed during 2012-13 pertaining to energy, labor, telecommunications and the financial sector are beginning to take root and cannot easily be reversed. These reforms are collectively expected to boost Mexico's GDP growth rate by at least 1% over the next several years. Second, renegotiations of NAFTA were completed in September 2018, which has substantially reduced the risk of a trade war with the United States. Finally, AMLO's leftist/populist leanings are likely to continue support for higher salaries, residential mortgages and the development of affordable urban housing in Mexico, which continues to be one of the more attractive risk-adjusted strategies to take advantage of the long-term growth opportunity in Mexico.

Brazil's Economic Recovery Receives a Political Boost in 2018

The period of 2014-2016 saw Brazil weather some significant social, political and economic challenges, driven by both internal and external factors. Lower commodity prices strained the government's finances, curtailing spending and precipitating the end of the leftist/populist *Partido dos Trabalhadores* or PT Party's rule. During this time, Brazil's economy endured its worst recession on record, contracting by over 7% in real terms from 2014 through 2016. As a result, the country lost its investment grade rating in 2015.

Brazil's economic recovery began in early 2017 and should remain on solid footing going forward. Inflation peaked at 10.5% in 2015 and has declined to the 4% range currently. [13] Greatly reduced inflation has led the central bank to reduce interest rates from a high of 14.25% during the recession to 6.5% today. Structurally lower interest rates should support higher asset valuations over the

[11] IMF.
[12] The World Bank.
[13] Banco Central do Brasil, Inflation Report September 2018.

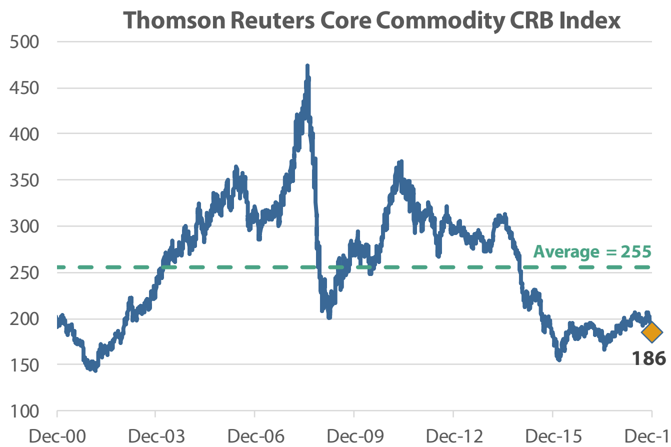
medium to long term, as lower cost of capital increases the present value of future cash flows. Finally, a recent constitutional amendment will curb growth in fiscal spending for the next twenty years. The economy is expected to grow in the 1.4% range in 2018 and 2%+ in 2019 and beyond.[14]

The political and economic outlook for Brazil received an additional boost in 2018 with the election of President Jair Bolsonaro in October 2018. While some of his past rhetoric on social issues has been caustic at times, Bolsonaro has immediately begun pursuit of an anti-corruption and pro-business agenda, including proposed pension reform and expansion of trade pacts. The markets have responded favorably with consumer confidence now near at a four-year high.[15] Further supporting Brazil's favorable macroeconomic outlook are the country's positive demographic trends: approximately half of Brazil's 204 million people are under the age of 30 and the middle-class has doubled in the past decade.[16] Brazil's large, youthful and increasingly wealthy and aspirational population are forming new households at an annual rate of nearly 1.5 million or about 7x the recent pace of new housing supply, which bodes well for new housing development well into the future.[17]

Other Regional Macro Factors

Commodities Prices Have Stabilized

The slowdown in China's economy since 2012 and resultant decline in the global volume and prices of commodities in 2013-2015 have had a negative effect on the currencies, fiscal balance and investor confidence in all emerging markets in recent years, including Latin America. However, the effect on all countries in the region is not the same. For example, lower oil prices help Chile which is a net importer of energy, but hurts the oil exporting countries of Mexico, Colombia and Brazil.



Commodity prices have stabilized since 2015 and are still near multi-year lows. The Thomson Reuters Commodity Index is 60% below its 2008 peak. While lower prices stimulate demand, since demand for commodities tends to be relatively inelastic, a much more important variable to price stabilization is the supply-side outlook. At today's prices, many commodities trade below their marginal production cost for high cost producers. As conditions at the higher end of the cost curve become uneconomic, production shuts down which reduces supply. Whether it be tar sands in Canada, shale oil in the United States, or sugar in India, investment in production has dropped sharply in recent years. In contrast, as noted above, Paladin Realty's target markets in Latin America are generally low-cost producers and continue to export the physical volumes of commodities they produce. Despite the difficulty in predicting commodity prices in the near-term, the fundamentals of the commodity cost curve do provide a floor value to prices and suggest a positive medium- to long-term outlook.

On the positive side, it is important to remember that approximately two-thirds of the economies in Paladin Realty's target markets are oriented toward domestic consumption. Therefore, even with the recent decline in commodities prices, other sectors of the regional economy are still viable and attractive, particularly after taking into account currency adjustments.

Local Currencies Stabilized Near Decades Lows

Following the decline in global commodities prices, local currencies in Latin America faced substantial declines relative to the U.S. dollar during 2014-16 and remain in a similar range today. Going forward, several factors suggest that local currencies will have a neutral bias or possibly provide positive tailwinds to U.S. dollar-based investors over the next few years. As discussed more fully in the recent Paladin Realty Research report entitled *Revisiting Currency Risk Today (Summer 2018)*, these positive fundamentals include:

[14] Ibid.

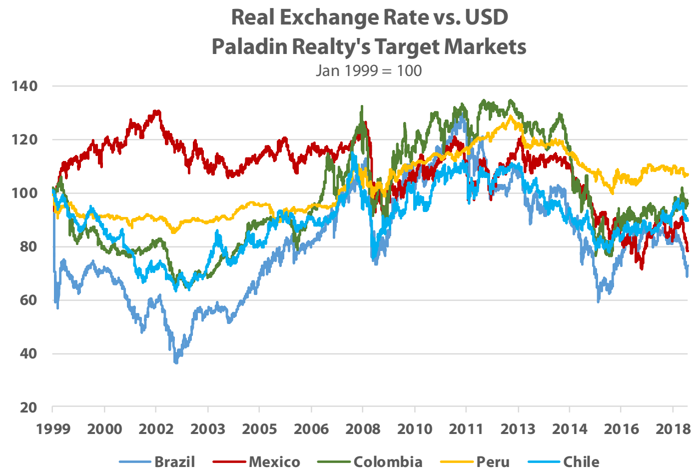
[15] Instituto Brasilerio de Economia FGV – November 2018.

[16] United Nations.

[17] Itau, IMF, Paladin Research.

(1) local currencies appear under-valued on a purchasing power parity (PPP) basis, (2) shrinking current account deficits, (3) stabilizing commodity prices as supply has decreased in the wake of lower global demand, (4) fair to under-valued real exchange rates that should revert to the mean over time, (5) interest rate differentials stimulating capital inflows to the region, and (6) improved visibility on the political front, as mostly investor-friendly leaders take office.

Paladin Realty believes that current exchange rates reflect an opportunity, both as an important adjustment mechanism for the real economies in the region, as well as for U.S. dollar-based investors and other investors deploying fresh capital in the coming years.



Strategy Implications

Latin America continues to offer global real estate investors a compelling and prudent investment thesis by targeting opportunistic returns (20%+ Gross IRRs) with highly visible and resilient demand drivers, superior project-level economics, and low leverage (providing downside protection) – either as part of a global diversification or tactical growth strategy. The region represents one of the most attractive long-term and large-scale growth opportunities in the world today, with favorable demographics and a population exceeding 400 million in Brazil, Mexico, Colombia and Peru. In addition, Brazil's recent recession and oversupplied commercial sector have created some unique near-term pricing dislocations. As a result, the next several years should prove to be an optimal time to deploy capital in the region through select real estate strategies, especially with currencies near decades' lows.

Paladin Realty's funds continue to follow these guiding investment principles honed from over two decades of experience investing in Latin America:

Key Investment Principles

- Target high margin, low debt investments with highly visible and sustainable demand drivers.
- Reduce risk and preserve control, deal flow, scalability, efficiency, and alignment of interests through programmatic joint ventures with proven local operating partners.
- Utilize the real estate development and operating skills of Paladin Realty's regional investment teams to employ rigorous asset management and execute select direct investments.
- Maintain diversified portfolio construction by geography, product type and partner. Additional diversification provided by many smaller assets spread across multiple markets.
- Pursue socially and environmentally-responsible investments with international ESG standards.

Low and Middle-Income For-Sale Residential Investments Anchor Paladin Realty's Strategy

- Attractive sector to capture the region's long-term growth opportunity and address a large regional housing shortage.
- Demand-driven opportunity fueled by a growing middle-class and annual household formation that greatly exceeds new supply.
- Greater access to long-term mortgage financing and favorable government programs substantially increasing affordability for homebuyers.
- Market risk mitigated through significant pre-sales, built-in exits, natural currency hedging attributes, repeat joint venture relationships, and Paladin Realty's 20 years of experience.
- Due to high profit margins, opportunistic equity returns can be targeted with low leverage (typically zero to 40% of total development cost).

Select Opportunistic Investments in Commercial Properties

- Overbuilding and a lack of debt and equity capital has created pricing dislocations of Class A office and industrial assets in certain markets.
- Positive trends in certain markets support the new development of other select property types such medical office, purpose-built rental apartments, lodging and mixed-use projects.
- When new development is appropriate, target underwriting to 250-500 bps of projected development profit (i.e., unleveraged yield on cost upon completion and stabilization less assumed exit cap rate).
- Relatively high cap rates in the region for prime commercial properties helps further mitigate cap rate risk compared to rich pricing of similar assets in the U.S. and other developed markets.
- Commercial investments are typically unleveraged, further mitigating risk.

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