07 - 26 - 2024

Corporacion Inmobiliaria Vesta SAB de CV

Q2 2024 Earnings Call

TOTAL PAGES: 19

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Q2 2024 Earnings Call

CORPORATE SPEAKERS:

Mariana Dominguez
Vesta; Investor Relations Coordinator
Lorenzo Dominique Berho Carranza
Vesta; Chief Executive Officer
Juan Felipe Sottil Achuttegui
Vesta; Chief Financial Officer

PARTICIPANTS:

Pablo Ricalde
Santander; Analyst
Gordon Lee
BTG; Analyst
Alejandra Obregon
Morgan Stanley; Analyst
Rodolfo Ramos
Bradesco BBI; Analyst
Wilfredo Jorel Guilloty
Goldman Sachs; Analyst
Isabela Salazar
GBM; Analyst
Andre Mazini
Citigroup; Analyst
Natalia Leo
JPMorgan; Analyst

PRESENTATION:

Operator

Greetings, ladies and gentlemen. Welcome to the Vesta Second Quarter 2024 Earnings Conference Call. (Operator Instructions)

At this time all participants are in listen-only mode. A question-and-answer session will follow today’s prepared remarks and as a reminder, this call is being recorded.

It is now my pleasure to introduce your host, Mariana Dominguez, with Vesta's Investor Relations team.

Please go ahead.

Mariana Dominguez

Good morning, everyone. Welcome to our Second Quarter Earnings call.

Presenting today with me is Lorenzo Dominique Berho, Chief Executive Officer and Juan Sottil, our Chief Financial Officer.

The earnings release detailing our second quarter 2024 results was released yesterday after market close and is available on the company's website, along with our supplemental package.

It's important to note that on today's call, management’s remarks and answers to your questions may contain forward-looking statements.

Forward-looking statements address matters that are subject to risks and uncertainties that may cause actual results to differ.

For more information on these risk factors, please review our public filings.

Vesta assumes no obligations to update any forward-looking statements in the future.

Additionally, note that all figures included here in were prepared in accordance with IFRS which differs in certain significant respects from U.S. GAAP.

All information should be read in conjunction with, and is qualified in its entirety by reference to, our financial statements, including the notes thereto and are stated in U.S. dollars unless otherwise noted.

I will now turn the call over to Lorenzo Berho.

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Lorenzo Dominique Berho Carranza

Thanks, Mariana. Vesta delivered solid second quarter results, driven by the sustained strength of our high-quality portfolio and great execution by our professional team. Leasing activity reached 2.8 million square feet, 1.0 million square feet in new leases, nearly half of which were buildings under construction, led by the e-commerce and consumer logistics sector as a result of strong demand we are seeing in the market. 1.8 million square feet of our leasing activity was in renewals and re-leasing spreads reached 7.1% during the quarter, consistent with last quarter and reflecting stable growth in rents in the overall market with low vacancy levels.

We reached 42.5 million square feet of GLA including buildings under construction and continue to see portfolio occupancy levels increasing. During the quarter, stabilized occupancy reached a record 97.5%.

Vesta's construction pipeline also continues to strengthen, ensuring we meet the demand we're seeing in the market. Our pipeline reached 4.7 million square feet during the quarter, of which 38.6% has been leased to date. Along these lines, 100% of the existing buildings within our Vesta Park Apodaca in Monterrey has been leased by second quarter's end. We also pre-leased a spec building in Monterrey during the quarter, and began construction on the only 730 thousand square foot large-format spec building to have been built in Monterrey to date, anticipating the considerable demand we're seeing in Mexico's largest industrial market.

Our business is led by two important drivers, first: Mexico's internal consumption and local and regional market demand. Deloitte estimates Mexico's GDP will grow 2.2% in 2024, then at a 2.1% average rate annually from 2025 to 2030, continuing the country's current macroeconomic direction of the low and stable growth we've seen post-pandemic.

And according to the World Bank, remittances accounted for 4.2% of Mexico's entire GDP in 2023, a number that is certainly higher now. Mexicans' purchasing power is, therefore, strengthening.

And nearshoring remains an important growth driver for Mexico. Last week, Fitch ratings affirmed Mexico’s sovereign rating at ‘BBB-‘ with a stable outlook.

Fitch cited a prudent macroeconomic policy framework, sound and robust external finances, and steady debt levels. The agency noted that nearshoring could continue to offer future opportunities for the country.

Foreign direct investment into Mexico reached over $38 billion dollars from January through May, according to Mexico's economic ministry, a 35% year-on-year increase with the heaviest investment during the period in the manufacturing industry, accounting for 21.8 billion, or 56% of FDI.

Vesta’s second quarter revenues reached $63 million, while adjusted NOI and EBITDA margins were 94.7% and 82.3%, respectively. Vesta FFO reached $37.9 million, a 23.2% year-on-year increase.

As our results for the quarter therefore reflect, Vesta is well positioned to capture related opportunities. We're focused on the right markets- Mexico's most strategically relevant manufacturing hubs- and our sights remain on the long term. And as I have noted in the past, we're highly selective regarding the markets and projects where we'll continue to invest and grow.

I'd like to reiterate Vesta's important differentiators: our outstanding asset quality is second to none. We have a long track record of leveraging close client relationships to identify unique and accretive opportunities, and a long history of exceptional execution and a deep understanding of industry dynamics and our markets’ nuances and challenges. Our capital allocation decisions have been, and will continue to be, measured and prudent. Finally, and importantly, we have proven our success of quickly and nimbly adapting to both react and to anticipate, with well-grounded decision making.

We will therefore continue to focus on delivering strong and consistent results with both hands firmly at the helm and the wisdom and confidence built through more than 26 years as Mexico's leading Industrial Real Estate developer.

As a final comment, we released our sixth audited integrated annual report during the second quarter about which we are extremely proud.

Please find it on our Investor Relations site.

With that, let me pass our conversation to Juan, and I'll return for some brief closing remarks.

Juan Felipe Sottil Achuttegui

Thank you, Lorenzo. And good day, everyone. Let me begin with a summary of our second quarter results. Starting with our top line, total revenues increased 22.4% to $63 million, mainly due to rental revenue coming from new leases and inflationary adjustments and rental property during the quarter. In terms of current mix, 88% of our second quarter revenue was denominated in U.S. dollars, up from 86% from the second quarter 2023.

Turning to our profitability, adjusted net operating income increased 19.6% to $57.8 million, while the margin decreased 77 basis points to 94.7%. Higher rental revenue from our rental properties was partially offset by an increase in insurance, property tax and other property costs, resulting in a lower margin.

Adjusted EBITDA reached $50.2 million in the second quarter, a 20% increase compared to the same quarter last year, while the margin decreased by 188 basis points to 82.3%, primarily due to higher costs and expenses. Administrative expenses during the quarter were impacted by the peso appreciation relative to the same period last year and the increase in auditing, legal and consulting expenses driven from our equity transactions.

We closed the second quarter of 2024 with a pretax income of $132 million compared to $108 million in 2023, which again this quarter, benefited from higher gains on revaluation of investment properties and higher interest income. Vesta's FFO increased 23.2%, reaching $37.9 million, as Lorenzo described.

Turning to our capital structure and balance sheet: cash and equivalents stood at $377 million, and our total debt remained unchanged at $914 million at the end of the quarter. Net-debt-to-EBITDA was 2.8x, and our loan-to-value was 22.9%.

On the back of our disciplined and prudent approach, we continue to maintain a strong financial position that enables us to keep on executing Vesta's strategic plan while delivering sustainable results.

Finally, subsequent to quarter's end and July 16, we paid a cash dividend of $16.2 million for the second quarter. This concludes our second quarter 2024 review.

Operator, could you please open the floor for questions.

Operator *(Operator Instructions)*
Thank you, your first question comes from the line of Pablo Ricalde from Santander.

Pablo Ricalde
Hi, good morning Vesta team, I have two questions. The first one in terms of expense line, you only mentioned administrative expenses was due to these audit expenses and the leasing. I just want to understand how should we see this line going forward? That's my first question.

We saw the projects delayed. Just trying to understand what is the reason for the delay.

Juan Felipe Sottil Achuttegui
Hello, good morning. I'm going to address the first part of the question, on the auditing expenses: indeed they have come up. As you know we defer the New York Stock Exchange on auditing expenses. In fact, a couple of other lines as well have become more expensive based on our obligations under the PCAOB. This requires a more extensive auditing review. And so that's the explanation. So that's basically what happened on that line.

Pablo Ricalde
But should we expect like to remain at these levels going forward? Or this is more like just one time in terms of the other expenses?

Juan Felipe Sottil Achuttegui

No. The auditing expenses will continue to be updated because of the extensive review that we have to comply with under the New York Stock Exchange.

Pablo Ricalde

Okay.

Lorenzo Dominique Berho Carranza

If I may add, we did experience a couple of delays on a couple of buildings, nothing material. It just took us a couple more months for one of the buildings to be delivered- it was supposed to be delivered in the quarter. But now we are aiming for that final project to be delivered in October – these were minor construction delays.

And I think another important part of the expense side is that we also experienced some maintenance expenses and energy expenses that we believe might be a one-off for the quarter. And at some point, that particular cost will stabilize and improve our margins, too. Thank you, Pablo, for your question.

Operator

Your next question comes from the line of Gordon Lee from BTG.

Gordon Lee

Hi, good morning. Thank you very much for the call. Just a quick question on your land bank- if I look at the land bank, it looks like at this point, you only really have land in the Bajio region. So I was wondering how quickly you think you'll be able to refill land either in the northern regions or in the central region /the Mexico City region?

Lorenzo Dominique Berho Carranza

Gordon, thank you for being on today's call. Definitely, land acquisition is a key part of our strategy. We have a very strong pipeline of land that is building up. We select the sites we acquire very carefully: urban infill as one of the most important attributes with locations where we can have good access to infrastructure, labor and differentiate ourselves as we have done in the past.

Sometimes it takes a bit longer, but we have a strong pipeline and we aim to be able to buy and replenish land reserves in the North and Central Mexico in the upcoming quarters, and that's going to be very helpful for the strategy going forward, which is based on development.

We will continue to do the same as we have done in the past. Fortunately, the reason why we - let's call it- ran out of land in some of the markets is because our development pipeline accelerated even more than we estimated. That's the case in Monterrey, for example. As you can see, we just started our final building within the Apodaca project. Even that it will take some months to be developed, we are out of land and what we have now is building under construction that we still have to market and lease. Nevertheless, with the strong market performance that we see, we think that these types of projects are going to be very well absorbed.

But definitely, part of our strategy is to continue buying land in great locations in the markets where we have a presence and continue growing within these sites during the company’s next growth stage.

Gordon Lee
And would you say on land prices and how they've developed and looking at that pipeline of land bank that you've built, would you still think that when you look at that versus rents in the market today that you would still be underwriting projects that sort of 10% development yields?

Lorenzo Dominique Berho Carranza
Yes, absolutely. So rather than getting into detail to each of the markets, Gordon, because all of the markets have different land cost bases, I think that the main driver of Vesta is to continue focusing on spread investment. Spread investment where we can have a higher margin to acquisitions, mainly 300 basis points. So yes, we can still achieve returns of around 10%.

If you look at the construction pipeline that we have right now, we have a yield on cost on average of 10.4%. So that will continue to be our main driver: our discipline, and our main differentiator to other players that focus their strategies on low-yield acquisitions.

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<u>Operator</u>
Your next question comes from the line of Alejandra Obregon from Morgan Stanley.

<u>Alejandra Obregon</u>
Hi, good morning Vesta team, thank you for taking my question. I was just hoping to get some color on the buildings that you currently have under construction. So you mentioned close to five million square feet that is under construction, in Aguascalientes and Puebla. I was just hoping if you can comment on the dynamics that you're seeing in these key markets. And more specifically, if you have received specific interest from potential tenants for these buildings? And anything on the dynamics of the market and of the market where you're expecting to drop these assets, that will be very good.

<u>Lorenzo Dominique Berho Carranza</u>
Alejandra, thank you very much for being on the call. Definitely, I think that one of the main attributes of Vesta is our ability to develop and as we have stated in the past, we will continue to find opportunities that drive profitability. And we think that current construction pipeline stands at probably the highest number we've seen, at 4.7 million square feet and a total investment of above $400 million of projects that we have just under construction.

And we have pretty much projects in most of the markets where we operate. Talking about the North, we continue to see strong demand in Ciudad Juarez. In Ciudad Juarez out of the projects that we have under construction, one of them is leased and the other one is still under development and with a good list of potential clients- clients in the electronics sector as well as the auto sector.

In Monterrey, we have now four projects under construction. We did an important lease to a very important e-commerce player. And while we had the building under construction, we were able to pre-lease it and this will help us to continue growth in this particular market and we can start other projects. In Monterrey we are well diversified between consumer goods, e-commerce and manufacturing. So this is a good example of how well diversified our projects are.

In the Bajio we have seen a good demand with rent increases, particularly in markets like Queretaro and Aguascalientes. In Aguascalientes we were able to sign a couple leases with some Japanese firms in the auto industry. And in Aguascalientes we have been able to renew several of our leases that were close to expiration, which shows important commitment from companies that want to expand their presence in Mexico.

And talking about the Central region: Mexico City is very hot, very strong. Last quarter we were able to lease to a major e-commerce player, but we see a good pipeline and particularly rents going up pretty quickly. And we're benefiting from our ability to anticipate market dynamics and trends. That's why we will continue to acquire land and develop. As long as we continue to see rents going up, we think that will continue to be the main driver of growth.

So this pipeline is a good example of what we will continue to see: a pipeline where we have not only spec buildings, but also buildings that are pre-leased. Almost one third are pre-leased, but the markets are still strong. We feel comfortable that as long as we continue delivering inventory buildings, demand coming from good quality companies will continue to be there.

Operator
Your next question comes from the line of Rodolfo Ramos from Bradesco BBI.

Rodolfo Ramos
Thank you, good morning everyone. So just wanted a little bit of a follow-up on the previous question. I wanted to get a sense of your commercial conversations. If you have seen a shift at all after Tesla's announcement in Monterrey and whether this has had any impact on clients potentially that we're looking at Monterrey or in the Bajio, if there is any type of cannibalization going on if we were to see more slack in the Monterrey market, or if the Bajio region could suffer as a result? Or if you see completely different dynamics? So that's the first one.

And just secondly, if you could give us an idea if you have any exposure to EV suppliers to the EV market currently?

Lorenzo Dominique Berho Carranza
Thank you, Rodolfo, for your question. I think it's worth talking a little bit about the announcement from Tesla. The Tesla announcement that the plant will be put on pause

is not necessarily a positive signal. However, it's interesting to see the drivers of that particular decision, which happens every now and then. Clearly, some of you follow the Tesla results: their sales volumes have dropped dramatically. They have entered other industry sectors- such as robotaxis and automated driverless systems. So definitely using the political statement to pause the plant is something that some of us actually were kind of expecting.

The Tesla project is a major project. But many of the types of clients that we have are not necessarily related to Tesla in Mexico. I think that most of the types of clients are well diversified among different industry players in the EV/electric vehicle industry as well as internal combustion. And therefore, we think that this should not have a major implication for other industries. And even for the auto industry, part of the supply chain is already both in Mexico and the U.S. And this should not have any effect.

Bear in mind that in order to manufacture cars, whether it is EV or internal combustion, and in order to be profitable, production has to be in a region where companies can be profitable and we can have reduced costs and can have integrated suppliers. And that's why even in the toughest times, companies expand in Mexico during tougher times when there's more challenges. So that's why we actually think that we were going to see even more suppliers in the industry coming to Mexico. Many of them are already in Mexico, and they are just expanding operations. And particularly in Monterrey: Monterrey is the largest industrial market and currently has very low vacancies. I would say that very few companies that were established in the last period in Monterrey were related to Tesla. Actually, the largest component of them are related to completely different industries and a completely different supply chains of other sectors.

Our project in Apodaca is contrarian to the site of Tesla. So it will be interesting to see the evolution after the news, but I think that Monterrey is a thriving city. We had our last Board meeting in Monterrey, and we were able to see the strong dynamics that that particular market has not only because of industrial sector but of services, quality of life, education. Its location also closer to the U.S. So we feel very comfortable continuing investing in Monterrey and other markets like Bajio where the auto industry has had a strong presence.

Operator

Thank you. Your next question comes from Jorel Guilloty from Goldman Sachs.

Wilfredo Jorel Guilloty

Thank you for taking my questions, I have two. So the first one is on leasing spreads. So we notice that your trailing 12 month leasing spread came at 7.1% this quarter. It was 8% in 1Q24. And I was wondering, what sort of leasing spread trends are you seeing? Are you seeing a leveling off to a lower level? Is it accelerating? It was what happened in 2Q, just a once and done sort of situation?

And then the second question is around your pipeline. So you have a pretty extensive development pipeline at nearly 12% of current GLA, and about all of it is on spec. So what I was wondering is when you are thinking about the potential lease-up for this pipeline, and what you've been seeing so far in the last six months year-to-date, are there any changes in expectations on how quickly you can lease up those properties? Are you seeing that window of leasing up becoming shorter? Are you seeing it become longer? How do you expect the negotiations to go for these new assets. So those are my questions, thank you.

Lorenzo Dominique Berho Carranza

Thank you, Jorel, for being on the call. I will start with the second question.

We actually have no changes in expectations towards our underwriting of each of the projects on spec. The process is that we start by analyzing the market. We see how the demand and supply are behaving. We start a spec building, and we have some time to lease up- maybe six months, 12 months after that. And that's when we underwrite a project at certain returns. Of course, in the process, sometimes we are able to pre-lease these buildings. And this is quite convenient because while you're under construction, particularly in strong markets, you can be able to lease up. And that's what currently represents approximately a third of the projects.

But for the rest, we feel very comfortable with the market dynamics, there is little supply of good quality assets like the ones that Vesta develops in the locations where we're at. And that's why even if we finalize the project without signing a lease agreement, we have some good time of marketing where we can push even prices and rents to our benefit and take advantage of having good projects available in the market and anticipate many of the clients that normally require the buildings, and when they take a building, they're already late on their projects. And that has been a key strategy of Vesta.

Actually, what we have seen is rents and spreads, interestingly, going up. If you look at the numbers of previous quarters, we have some returns, let's say, closer to nine -- between nine and 10. And now we're seeing returns even above 10%. This is a result of higher rents, limited supply for good quality assets and our ability to close better transactions. And of course, all of them in dollar rents, long-term leases, adjusted to inflation, and keeping the same standard going forward.

As to your first question, I think that we will continue to see rent increases and net effective rent increases on the re-leasing spreads. Every quarter is kind of different, depending on the amount of leases that you've got. But if inflation in the U.S. is, let's call it, close to 3% we will continue to see maybe a spread getting closer to high single digits in terms of rent spreads overall. And the reason being high single digits is a combination of existing, some expiring leases that take effect with CPI increases or some of them that we can be able to take to market, and we have seen in some markets some increases between 20%, 30% and even 50% rent increases, depending on the market.

So that's going to be a dynamic that we foresee in even the next years to come as long as some leases expire, and we are able to take the leases up to market.

Operator
Your next question comes from Isabela Salazar from GBM.

Isabela Salazar
I was wondering what your general view is of the new administration regarding their willingness to facilitate access to infrastructure, energy and water that is crucial for development.

Lorenzo Dominique Berho Carranza
Isabela, thank you for your question.

We have high hopes that the new administration will act on what matters most for the industrial sector and manufacturing sector, which is a great opportunity for Mexico, with nearshoring opportunities.

I think they have identified very well the importance of industrial parks. Claudia Sheinbaum is the first candidate, now President, that has had a plan in place even before taking office. She has commented that she would like to have more than 100 industrial park projects. So she knows how important this is in order to attract investment, how important it is to generate well-paid jobs, and to generate also the opportunity to bring in better infrastructure. So we have high hopes that the energy sector will probably show a shift to what we have seen previously as well as some other infrastructure requirements.

In that regard, we have been very close contact with the new administration and some of their key officials through the Association of Industrial Parks as well as other business councils where we participate, in order to make sure that we can support the growth opportunities for the country and that the industrial and manufacturing platform is strategic for this new administration.

So in that regard, we think that they understand well. They know what Mexico has to do. And hopefully we can also support them in order to be able to facilitate the improvements that are required, particularly in energy and other logistics infrastructure.

Operator
Your next question comes from the line of Andre Mazini from Citigroup.

Andre Mazini
So my question will be a follow-up on the statement from the government that they want to support the construction of 100 industrial parks: what exactly do you think they are meaning here? I don't think it will be government money for industrial parks themselves, right? Just make regulation better, maybe lower taxes? What are the complete measures they could take for the so-called 100 parks construction would you say?

And on the other measures, in terms of like energy, do you think they could open up the monopoly in transmission and distribution away from the CFE to have private money because I think this would be the measure that will really assuage concerns.

Lorenzo Dominique Berho Carranza
Thank you, Andre. Mexico needs heavy investment in energy and particularly in transmission distribution and in some ways also in generation. Definitely, the government has its limits in terms of spending. And that's why the private sector will have to play a role in energy. I don't know exactly the details on how they want to open up. Hopefully, they can generate a plan that is helpful for the private sector- not only for energy, but also hopefully renewable energy. And we think that under Claudia Sheinbaum’s leadership there will be an opportunity on renewable energy.

And this has an important impact on the plan of 100 industrial parks. I don't think that the government will be supplying money directly to the parks. I think that it's more about giving support to whoever develops the parks in different regions of the country that are making sure that there is good interaction so that the parks can overcome certain challenges on infrastructure and energy, also working closely with local governments and local authorities because this does not come only from the federal government. So I think this is a good plan. It's good for them to understand what the park developers might need.

But also the other part of the opportunity is attracting foreign direct investment. I think the Secretary of Economy understands this well, also the office that links the business leaders to the government led by Altagracia Gomez. I think she’s doing a fantastic job in this regard. And I think that it's also a good part for us as to how far we can take the country and how far we can make this an important plan.

But I think that actually it's interesting that we don't need funding from the government to establish opportunities. We just want them to understand the opportunity and keep supporting it. And we can find ways to invest. And hopefully these could be great years to continue to attracting investment in the manufacturing sector.

Operator
Your next question comes from the line of Javier Gayol from GBM.

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Javier Gayol

Hi. Thanks for the call and congrats on the results. After the recent election and financial volatility, have you seen any changes in customer demand for space? Are customers more cautious or does it remain the same? And also, are you exposed to any Chinese tenants?

Lorenzo Dominique Berho Carranza

Thank you for your question. The result of the election was something that international companies that are established in Mexico expected. It was kind of a default scenario that Claudia Sheinbaum would win. For that reason, I think many of the projects actually did not have a major impact before, during and a little after the election. So, in that regard we don't see any major changes, and they have already considered that Claudia Sheinbaum might take office.

Maybe the only thing that I think some companies might be just more cautious about is on the U.S. elections, which is understandable. And I think that in that regard, we think that many companies understand well how Trump plays because he has been President in the past. Now with a new candidate or potential candidate from the Democrats, it's a little bit of kind of the same what we have seen until today.

The revision of the USMCA in 2026 will be important. And for that, I think that there's a good expectation that the negotiation is going to be tough as always, but the outcome is going to be positive just because it's a great agreement that might need to have some tweaks. For that reason, I think that's something that just the companies might consider. But in the end, I think that there's no other place better than North America. The integration of the three countries has had great results in order for the U.S. to be able to reduce your deficits to other parts of the world.

And regarding Chinese companies in Mexico: we're very careful regardless of the nationality of our clients. We have companies with very high credit ratings, as an important criterion. Very solid finances and strong reputations in the industries where we operate, regardless of nationality.

So in that case, it's hard for us work with that many of the Chinese companies arriving in Mexico. And that's why we have very few Chinese clients. The only ones that we have are pretty much larger corporations that are more like global companies, TCL for example, in Tijuana, producing flat screens and electronics. We have a few others in the auto sector that were German companies that are owned through Chinese capital but have had a huge track record in the sector. So we are very selective. We will continue to maintain a very well-diversified portfolio, and we're going to continue maintaining Vesta's strong discipline related to how we select our clients. Chinese companies are still coming, and they might be going with other developers, and we think that's fine. We will focus on our own portfolio to have a good quality.

Operator
And your next question comes from the line of Natalia Leo from JPMorgan.

Natalia Leo
Thank you. Good morning, everyone. And thank you for taking my question. Mine is more related to the cost per square meter of your development pipeline, so it increased around seven percent sequentially and like 41% year-over-year. And especially in one of your developments in Mexico City, I just wanted to understand if it is more related to construction costs or land? And how do you take into account land to determine the yield?

Lorenzo Dominique Berho Carranza
Great. Thank you for your question. Well yes, definitely, Mexico City is the place where land is most expensive and that's why all in cost per square foot or per square meter is the highest, particularly compared to other markets in Mexico. And construction costs have also had an increase in costs, particularly materials have increased maybe 10%, and also the exchange rate, which was below $17 has had an impact in some of these costs. Now that over $18 clearly things are different but our underwriting is on the conservative side and not on the current exchange rates. So for that reason, we see higher costs.

However, particularly in Mexico City, we are seeing rents that are now in the $11, $12, $13 per square meter range. This is much higher than any other market throughout Mexico, particularly for high-quality buildings like the ones that we're developing. And so that increase in rents offsets the increase in costs that we have seen. That's why if you look at the projects we have in Mexico City, Punta Norte for example, we have returns above 10%, which is great. Particularly in a market has a greater barriers of entry. We have urban infill locations. These projects are very hard to replicate and replace. And that's why sometimes we'd rather pay a bit more of a price in land but knowing that there's going to be long-term value through it. And yes, sometimes it might be higher cost per square foot or per square meter. But as long as it makes sense in terms of returns, and that we think that the spread investment on returns will continue to be key in our capital allocation strategy.

Natalia Leo

Perfect. And just to be clear, your leases in Mexico are in dollars or in pesos?

Lorenzo Dominique Berho Carranza

Definitely our leases in Mexico City are in U.S. dollars. So you're seeing returns at 10% in U.S. dollars. And I think that explains well the discipline that Vesta has in taking good companies, making the leases in U.S. dollars and continuing to drive long-term value for our portfolio.

Operator

There are no further questions at this time.

I'd now like to turn the call back over to Mr. Berho for his concluding remarks. Please go ahead, sir.

Lorenzo Dominique Berho Carranza

Thanks, Operator. And thank you, everyone, for joining us today. Vesta’s second quarter results are consistent with our long-term strategy and focus on continued value creation. Today, we're in a position of strength and forward momentum. We will maintain our strong financial position, which enables us to further execute on Vesta’s strategic plan, with sustained results strength, leveraging our Company's ability to create value.

I'd again like to thank the entire Vesta team for their important contribution to our performance.

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