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Vesta Industrial Real Estate

Third Quarter 2017 Results Conference Call

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Vanessa Quirota, *Credit Suisse*

Marimar Torreblanca, *UBS*

Alejandro Lavín, *Citigroup*

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PRESENTATION

Operator:

Good morning. My name is Christine and I will be your conference Operator today. At this time, I'd like to welcome everyone to Vesta's Third Quarter 2017 Earnings Conference Call. Vesta issued its quarterly report on Thursday, October 26, 2017. If you did not receive a copy via email, please do not hesitate to contact the Company at: +52 (55) 5950-0070.

Before we begin the call today, I'd like to remind you that forward-looking statements made during today's conference call do not account for future economic circumstances, industry conditions, company performance, and financial results. These statements are subject to a number of risks and uncertainties. All figures included herein were prepared in accordance with IFRS and are stated in nominal U.S. dollars unless otherwise noted.

Joining us today from Vesta in Mexico City is Lorenzo Berho, the Chief Executive Officer, Juan Sottil, the Chief Financial Officer, and Christianne Ibanez, the Investor Relations Officer. Also present on our call and available for your questions is Lorenzo D. Berho, Vesta's Chief Operating Officer.

I would now like to turn the call over to Mr. Berho. Sir, please begin.

Lorenzo Manuel Berho Corona:

Thank you, Christine and good morning everyone. Thank you for your interest in Vesta and for participating in today's conference call.

Today I am very pleased to report that our third quarter results build on Vesta's track-record of excellence. This quarter, the effectiveness of our strategy was evident in a third consecutive record high for occupancy at 95.8% for our stabilized portfolio, and the second consecutive record high at 92.7% across our total portfolio. This reflects the strength and dedication of Vesta's industry-leading Business Development Team.

While the Mexican market has experienced volatility, our supply chain has demonstrated its resilience, a dynamic reflected in Vesta's record results, and one that bolsters our unwavering confidence in the Mexican investment case. Our Management Team is focused on capturing opportunities by establishing an efficient platform to serve new and existing clients, supported by our robust balance sheet and the most competitive debt profile in the industry.

Overall leasing activity was 1,400,000 square feet in the third quarter, as Vesta signed new leases totaling 1,160,000 square feet, including 474,000 square feet of inventory buildings, and build-to-suits for 684,403 square feet. In addition, Vesta renewed leases for 226,000 square feet of its portfolio. Vesta keeps growing with this thriving client base who represent 77% of our—of new leases. We signed four new build-to-suits with TPI, BRP, both in Juarez and Nestle General Mills joint venture company CPW. We also leased our inventory space, further diversifying our portfolio with new and existing global client, including Daimler, HVPO, NKPN, among others. Leases were signed across our different strategic regions where we continue to see strong demand.

In terms of financial toward key financial metrics, revenues rose 23%, while EBITDA was 25% higher versus the same quarter last year. Over nine months, revenues increased 22% compared to the same period of 2016. Funds from operations, FFO, were up 7%, mainly due to higher revenues year-over-year. FFO per share rose 10% against the same period of 2016. Compared to the past two quarters, taxes have normalized to a rate more similar to historical average, giving us confidence in our expectation of higher FFO per share by the end of the year.

Regarding our capital structure, our highly-competitive cost of financing is supported by recent transactions. In September, Vesta executed an investment-grade bullet bond non-secured private placement. This transaction was completed at highly-competitive rates, which Juan will give more detail shortly. Vesta's 6.8-year average debt maturity also provides important flexibility against its 5.4-year average lease maturity. As ever, we're executing our strategic Vesta Vision 2020 Plan, as we develop programs that address the future needs of our global manufacturing and logistic client base.

Due to the combination of our focused Management Team, state-of-the-art facilities, and strong fundamentals in the most dynamic markets, we continue to see our record-breaking trend in operational results in the coming months for a better than expected year end 2017. As we have noted previously, while uncertainty surrounding NAFTA remains, our confidence in Vesta's outlook is supported, not only by our business' trend, but a dynamic whereby Mexico underpins North America's competitive position. Our skilled and efficient workforce enables the U.S. auto industry, among others, to remain globally competitive, while over five million U.S. jobs depend on Mexican exports. As we look to the future, we remain cautiously optimistic that Mexico will continue to strengthen its position as a competitive global manufacturing hub.

In summary, Vesta has proven that challenges bring out the best in our business and from our team. Our infrastructure is robust and our focus is unwavering. Thank you, and I will now turn the call to Mr. Juan Sottil, our CFO.

Juan Felipe Sottil Achutegui:

Good morning and thank you everyone for joining us. As Lorenzo mentioned, Vesta once again achieved record high occupancy, and along with a strong financial metric. This is evidence of our industry-leading position, close customer relationship, and ability to capitalize on the ongoing global demand for best-in-class industrial facilities in Mexico. Our track-record of double-digit growth in revenues and EBITDA continues, both over 23%, as our vacancy rates held.

For the third quarter, Vesta portfolio was 24.6 million square feet, with strong occupancy results on same-store, stabilized, and total portfolio. The vacancy rate for the total portfolio was 7.3%, down from 9% from the previous quarter, and 9.7% a year earlier, reflecting sequential trends. We signed leases totaling over 1,386,000 square feet with existing tenants and new global companies across sectors. During the quarter, Vesta had over 2.3 million square feet in both build-to-suit facilities and inventory buildings under construction, which are expected to contribute around $11.8 million to rental revenues once stabilized. The return on cost on this project is expected to be 11%.

Regarding key financial metrics, revenue grew over 23% to $28.2 million. As of the third quarter, Vesta has renewed over 87%, 17%, and 20% of leases due to expire in 2017, 2018, and 2019 respectively. Net operating income was nearly 23% higher to almost $27 million. NOI margin was 50 basis points lower to 96.2 due to a time lapse between tenant improvement upfront payments related to new leases in the third quarter of 2017, and future rent inflows from the corresponding new leases. EBITDA was 25% higher to nearly $24 million, and EBITDA grew 120 basis points to 84.7 year on year.

Total comprehensive income was $14.3 million versus $16.5 million in the previous year, due to our lower gain in revolution of investment property in this year’s third quarter. Funds from operations were more than $15 million from just over $14 million a year earlier. This reflected higher revenue in the third quarter of 2017. It is important to notice that the taxes spent provision has dropped compared to the past two quarters due to the peso depreciation during this quarter, given the strong feelings in our expectation of higher FFO by the year end.

As Lorenzo mentioned, during September Vesta executed an investment-grade, non-secured bullet private bond. This consisted of a seven-year maturing placement of $65 million with semiannual coupons at 5.03%, and a 10-year maturity placement of $60 million with a semiannual coupon of 5.31%. In this year's third quarter, we also hedged the valuable component of our interest rate, locking in a 6.55 spread between our weighted average cost of funds at 4.49% and our weighted average cap rate on the asset side at 11%.

Regarding our balance sheet, cash and cash equivalents were $142 million. Operating activities as of September 30, 2017 generated cash flow of nearly $121 million. Investment activities were primarily related to payments for construction in progress of new buildings in Bajio, Ciudad Juarez, Tijuana, and Puebla. Total investments for the quarter were over $23 million. Our disciplined operating approach means our cost of debt remains low as Vesta maintains a strong and efficient balance sheet to support our ambitious growth plan. At the quarter end, we had an overall debt balance of just over $510 million, all related to long-term liability. Our debt is denominated in dollars, and we can positively address any upcoming maturity.

Vesta, as Mexico's leading real estate Company, continues to build on an outstanding track-record for long-term, sustainable growth as outlined by our Vesta Vision 2020 Plan. We look to the future with confidence and look forward for—to updating you in our progress. Thank you all for participating in this call, and Operator, can you please continue?

Operator:

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please, while we poll for questions.

Thank you. Our first question comes from the line of Gordon Lee with BTG. Please proceed with your question.

Gordon Lee:

Hi. Good morning guys. Thank you very much for the conference. I have a couple of questions. The first on, I guess it's more on NAFTA, Lorenzo, which is I guess you would agree that no NAFTA is probably better than a bad NAFTA, and I was wondering whether, with the proposals that you have seen and that have sort of trickled through to the public, what of what is being proposed by the Trump administration would make you feel that that would be a bad NAFTA, and that no NAFTA would be better? The second question, I guess, somewhat related to that, is the last time that we were in a situation a little bit like this one, it was a bit more severe, but with the anxiety around NAFTA being probably overly priced in your stock, you decided to pull back a little bit on development and to direct more cash flow towards (inaudible). Are you thinking about that again, as we sit here with this anxiety today? Thank you.

Lorenzo Manuel Berho Corona:

Hello Gordon and thank you very much for your—both your questions, and I'm happy to share with you. You were asking about NAFTA, and we pretty much—as we presented in our Investors' Day in June, we are convinced that the industrial systems is much more important than the treaty itself. The amount of investment in Mexico, the skill of our workforce, and the competitiveness that Mexico has gained and helped North America is here to prevail, so we're tracking, as everyone else, the progress, and we know that there will be ups and downs in the next rounds, and of course it's up to the negotiation teams, and of course, what they can achieve, and hopefully they are able to renegotiate and have a good agreement for everybody, which is the will and which is the only thing that would make sense is to have an agreement updated, which 23 years ago this was the best agreement—commercial agreement in the world.

By the way, the three teams negotiated very hard in the TPP to have TPP as the best agreement ever, and many of those things are the ones that they are trying to incorporate to this agreement. That's the output that we would love to see, a new modern and updated NAFTA, 2.0 as somebody called it. Now, what we would not like to see is especially what our negotiations have been confronting, which is (inaudible) or have 50% manufacturing in the U.S. in the auto industry, or having the sunset clause. Of course, all that is unacceptable, and that's very clear, and I think that Mexico and Canada had a very strong position by the closing of the Ford plant.

We're positive in a general sense, because we see strong demand in every single market, and companies keep looking forward with a long-term vision and nominating from the OEMs keep moving, and that's where we have been at the level in every single place. Our diversified, geographically, and sectorial portfolio is showing that, and the results, not only this quarter, but permanently, especially the last four quarters of this Company. Since President Trump was elected have been the best quarters ever in the Company, so that is my comments related with your first question.

Your second question, Gordon, I don't think that we ever mentioned that we were going to stop our Vesta Vision Plan. We have been keeping up to that, and you can see that quarter-by-quarter as we're presenting that today. As long as we are seeing demand, and no reasons to change the speed of growth and the leasing activity, that's what we will continue to do.

Gordon Lee:

I think at the beginning of this year you channeled cash flows more towards buying back shares than you would otherwise have, because obviously, the stock price over-reacted to the anxiety around NAFTA. I think you could argue that the same is happening now. Would you consider revamping that buyback?

Lorenzo Manuel Berho Corona:

The buyback program is a program that we have set—even previously to President Trump's election we had the program set up. It was approved by our shareholders, and as any program to buy back shares, it's a program that we use it when we feel that it's the right time to use it, and when we believe in the progress and when the net asset value versus the market value makes the sense in order to act and to buy the shares, so if we believe that those are opportunity to buy, we have been buying, and that represents the confidence we have in the Company, the opportunity that we see, and the (inaudible) that we have in Mexico's competitiveness industrial platform.

Gordon Lee:

Understood. Thank you very much.

Lorenzo Manuel Berho Corona:

Thank you, Gordon.

Operator:

Our next question comes from the line of Adrian Huerta with JP Morgan. Please proceed with your question.

Adrian Huerta:

Hi. Thank you. Good morning everyone. Two quick questions. One is this new asset in Matamoras that you're going to build. Are you planning on getting more exposure to the northeast of Mexico and other border cities within the northeast, or other cities? The second question is regarding the leasing activity. You mentioned that you had a little more than 100,000 of square meters of leasing activity to new clients, but when looking at the net absorption it was around 40,000 square meters, so does that mean that you had a lot of leases expiring in the quarter that were immediately leased to new clients? Thanks.

Lorenzo D. Berho:

Hola Adrian. This is Lorenzo Berho. Good morning. Regarding your first question, TPI, as you well know, is our client in Ciudad Juarez. We have developed two properties for them, and in this case—and this is similar to other cases that we have previously done—we like to expand our operations with existing clients, and this is a way Vesta has partnered up in different other situations, and this is another case in which a client needs to keep on growing in a different region because it makes sense for their own business, and we, as partners, are developing this particular build-to-suit project in Matamoras just because we want to follow their expansion requirements. Honestly, we have been focusing in being the leaders in each one of the markets where we are at. The case of Juarez for example, we have been the most active developer in the last years. The case of Tijuana, we are also—we have been very, very active in the market where we have almost 100% lease of our properties, and it's a very strong, dynamic market, and in this case, I can tell you that we're only growing because a client needs to grow. We will keep on focusing in the strong border markets.

Now, talking about your—trying to answer your second question, yes, we had roughly 475,000 square feet of—in terms of leasing activity of inventory buildings. We believe this is a pretty good number, particularly because most—in most of these cases it has been in brand new inventory buildings that we have delivered in Guanajuato. Definitely our occupancy rates in these particular regions is also increasing, and nevertheless, we—this is only the reflection of the deals that we have been closing, and—but we have still a very strong pipeline which will—in the end, we'll be—we will be accommodating some of the tenants in our existing inventory buildings these are very high-quality industrial properties in very strong markets, and we believe that the tenants are really identifying good opportunities by using our properties.

Let me tell you that, in other cases, what we have done is—since we have a strong portfolio with a big client base. We're always accommodating the requirements of our clients, so we have done renewals when the clients need, and sometimes we do re-leasing with existing clients whenever there's an opportunity to take a building which is adjacent, for example, to their own facility, so we do these swaps very often in order to accommodate their requirements, and that's why we have been active in the re-leasing—in our re-leasing strategy. It was 226,000 this quarter, but during the whole year we have been able to re-lease—I mean to renew 85% of 2017 expirations, and 70% of the expirations for 2018, so looking forward, we have very few expirations in the upcoming months, and I can tell you even upcoming years, which makes our expiration profile very, very strong in the next couple of years.

Adrian Huerta:

Excellent. Thank you. Very clear, Lorenzo. Appreciate it.

Lorenzo D. Berho:

Gracias.

Operator:

Our next question comes from the line of Vanessa Quirota with Credit Suisse. Please proceed with your question.

Vanessa Quirota:

Yes. Hi. Good morning and congratulations to all the Vesta team. I have a couple of questions. One is also on the NAFTA topic. One of the concerns of the scenario—in the scenario of NAFTA being cancelled the reciprocal taxes that Mexico could pose on imported goods, and that could include trucks, which would increase the production cost in Mexico. Do you have any view, or have you heard any feedback from the industry about what could be done if this is the case under that scenario? The other question that I have is about the announcement. Did you see any reaction from your suppliers in the Guanajuato area, or any change in the pace of request for proposals after the announcement and the expected investment for the plant in Guanajuato? Thanks.

Lorenzo D. Berho:

Hola Vanessa. Good morning. This is Lorenzo again. Regarding your second question, Toyota did adjust its plans on production for the Guanajuato project. As you know, this project is still under construction, and it will be—it will start operations, I believe, in 2020. To be honest, what we have today is a very strong automotive cluster, particularly in the Bajio region. Toyota is one of them. We have Honda, Mazda, Nissan, Mercedes, BMW, and many of them are starting in the next couple of years, so in the end, the strategy of Vesta has not been to only be developing industrial buildings for the supply chain of one particular client. We're doing them for the whole industry, and the whole industry is considering OEMs in Mexico, and even OEMs that are abroad and suppliers that want to take advantage of the competitive position of the Bajio and the competitive position of Mexico.

In the end, we welcome new investments and we understand that the OEMs might have their own changes, and I believe their investments, in the end, are for the long run, so any adjustments they will do today, it's going to be minor compared to the rest of the investment that we foresee in the upcoming future. In the end, we want to have—we want to keep on attracting potential suppliers. We have been doing so. Our pipeline is, I can tell you, very robust. For the next quarter, it will show same—similar results to what we have done in—during the year, so we're very confident that we are developing in the right markets at the right time.

Lorenzo Manuel Berho Corona:

Hello Vanessa, and I thank you for your questions and your interest in Vesta. Related with your first question, again, with NAFTA, with many of these things is too early to tell. I mean we are tracking, as everybody else, and right now it's important to understand that the most tension that we see is inside the U.S. between Congress and the White House, and even with the private sector, so all this tension is reflected in the two-thirds (phon) of the positions and—but you never know, sadly, what is going to prevail. We know that we have flexible systems, and this is where Mexico having strong institutions from being a democratic country and having such strong institutions, we have to react to whatever we can when time comes, not before.

Just to give you an example, we were able to see the pulling out of Ford, assuming that they were going to produce the Focus in the U.S. It ended up being produced in China, and now they're exporting cars to the U.S., and they are paying 2.5% for the whole car, and all the components made in North America; North America meaning Mexico, the U.S., and Canada were lost to China just because that decision. We just need to wait. We know we have strong institutions and we have flexibility to adapt, but the most important part is, I believe, is the World Trade Organization is very strong on the positions. We know that. Our tariffs are very low, and Mexico is very competitive.

Vanessa Quirota:

Thank you for the answers.

Lorenzo Manuel Berho Corona:

You're welcome.

Operator:

Our next question comes from the line of Marimar Torreblanca with UBS. Please proceed with your question.

Marimar Torreblanca:

Hi guys. Thanks for the call and good morning. I am changing gears a bit. I wanted to know about your FFO conversion, because this quarter looks pretty good, and mostly this is due to the reversal of the FX effect on your taxes (phon), and I wanted to see if you could give us some guidance on what to expect for this 4Q and going forward. Is your exposure to FX still going to be—still be similar in taxes, and therefore in your FFO?

Juan Felipe Sottil Achutegui:

Marimar, thank you for the question. Look, indeed, what we do in the year is estimate our tax account that we will have to pay at the end of the year. Regretfully, the tax account is somewhat a function of the exchange rate in the sense that, from the tax authorities point of view, what we have is peso Company and a dollar liability, and therefore if the peso depreciates, we have a tax loss carry-forward, but if the peso appreciates, we have a taxable gain, and what has happened over the last—over this year is, at the beginning—at the end of last year we basically converted our tax loss carry-forward, because the peso moved from 15 a couple of years ago to 20 last year. We converted that tax loss carry-forward into depreciation by doing some assets sales between subsidiaries.

Now, what we didn't expect was that the peso was going to appreciate from 20 pesos to a low of around 17.80 as of the end of the second quarter, that’s taxable gain, and I underline taxable gain because there is no cash flow involved—implied a substantial assumption on the payment of taxes as of the end of the year. As the peso has depreciated from the second quarter—right now at the end of the third quarter it was 18.2. Today it's 19 point whatever, our expectation of tax payments have decreased substantially, and this indeed affects our FFO, but I will invite you all to look at the trend of FFO.

Last year, our FFO was around seven and three quarters of a cent per share. We (inaudible) to the tax affect. I believe that this year—we (inaudible) the tax affect, I underline. The FFO of this year will be pretty close to $0.11 per share, and that very strong trend over the next years will remain.

Now the recent tax component on this particular year, which is one off. One that is mark-to-market, that 19 and whatever, the only way that the tax will repeat itself is if the peso appreciates. I believe that the underlying strength of our growth in sales, our very high conversion from sales to EBITDA, and our incredibly attractive debt profile, with very low interest rates, will imply that our FFO will substantially grow over the next years, and I don't believe that this tax exposure will be significant looking forward.

Lorenzo Manuel Berho Corona:

If I could add, Marimar, and thank you for your question, I think that another important component of the FFO is the fact that Vesta will not have to dilute our shareholder base for the rest of the Vesta Vision 2020 Plan. This was a strategy that we had in order to get, let's say, the hit first by doing our second follow on early in 2015, get a very strong balance sheet, and now only with debt will we be able to fund the growth program that we have according to the plans, and that translates to a very strong position going forward in FFO per share.

Marimar Torreblanca:

Thank you, guys.

Lorenzo Manuel Berho Corona:

Thank you Marimar.

Operator:

Our next question comes from the line of Alejandro Lavin with Citi. Please proceed with your question.

Alejandro Lavin:

Hi. Good morning. Thank you for the call. Congrats on the results. I have a couple of questions, the first one on occupancy. Obviously, you have had a very strong occupancy lately. How do you see that evolving over the next couple of quarters, especially as you have developments coming online? Second question would be on rent. How do you see Vesta's rents compared to the markets in the three regions that you operate in? Do you think they are roughly in line, or do you see some opportunity to catch up to the market? Thank you.

Lorenzo D. Berho:

Well, Alejandro, good morning. This is Lorenzo Berho again. Yes. We were very happy with the results, particularly on the occupancy level. As you know, we have—since 2015 we have tried to give a better view on the three different portfolios. We honestly think the stabilized portfolio is the one that really reflects what the occupancy of the Company should be, since the total portfolio has many new inventory buildings. We have increased 200 basis points from the end of last year until today, from 93.8% to 95.8%, which is a very healthy number. Looking forward we believe that occupancy levels will be, still, very healthy, particularly because the projects where we are—the inventory buildings that we are currently developing are in very, very strong markets, which are Puebla, in Ciudad Juarez, and in Tijuana. Of course, every time we have inventories building under construction is because we know how the demand is for each of these markets. We have leading positions in these regions. We are very close to existing clients and potential clients, and our plan is, as soon as we develop—as we finish the buildings, that we can stabilize the buildings pretty soon. That combined with the size of the portfolio, we think that is going to hold our occupancy levels in very high levels.

Regarding your second questions on rent, let me tell you that we think that our clients are really appreciating the type of buildings that they're getting. Therefore, they are paying pretty good rents. In some cases, market; some cases, even above market, because they can differentiate our buildings to other ones that are in the markets, and that, together with the low vacancy rates in most of these regions is helping us, not only achieve high rent in—even above what we were doing in the last years, and that translates into very high returns of investment. In some of these cases, about 11%, even sometimes closer to even 12%, if you consider also the final numbers to each of these properties. In the end, we like the returns. We like the rents, and the market fundamentals are in the position where we feel very comfortable doing some inventory buildings in certain markets.

Alejandro Lavin:

Okay. Thank you. That's very clear. Congrats.

Lorenzo D. Berho:

Gracias, Alejandro.

Operator:

Our next question comes from the line of Armando Rodriguez with Signum Research. Please proceed with your question.

Armando Rodriguez:

Good morning everyone. Thank you for the call. Considering this strong demand and your occupancy levels, you mentioned that you are forecasting maybe positive rents over the next quarters, but what about the different margins; for example, EBITDA margin? Do you feel comfortable with these levels this quarter, that it was standing levels? Thank you very much.

Juan Felipe Sottil Achutegui:

Armando, Thank you for the question. Well, as you know, our EBITDA guidance is 83%, and we're comfortably above that, and again, we have a very high conversion from revenues to EBITDA due to the fact that we don't have any fee payouts to—for our activities. All of us are employees of the Company, therefore any gains saved quickly translates to gain in EBITDA. I will invite you all to take a look at our development portfolio. Again, this year we have—around 30% of our developments are build-to-suits, so guidance next year is going to be pretty good, and I will provide guidance as soon as possible, but you can figure it out.

Now, if you look at—over Vesta in the long-term, I do believe that we have achieved certain unlimited economies of scale, and I think that over the long term I can see that EBITDA will comfortably grow from 83% to a higher number, and we will see that as Vesta achieves its 2020 goal of more than 34 million square feet. I think that, at that time, EBITDA will comfortably be above 84%, 85%, but it will take a couple of years, but EBITDA conversion is quite high the reasons that I stated, and EBITDA outlook over the long term is very positive, in my opinion.

Armando Rodriguez:

Okay. Thank you very much, Juan, and congratulations on the results.

Juan Felipe Sottil Achutegui:

Thank you, Armando.

Operator:

Our next question comes from the line of Eugenio Saldaña with GBM. Please proceed with your question.

Eugenio Saldaña:

Hi guys. Good morning, and congrats on your results. I have a couple of questions. The first one is regarding your announced expansions this quarter. I was wondering whether you have identified more opportunities like this within your current clients, and in case, I mean how much GLA could it represent? The second question is regarding the cash that you raised from the private bond. Are you going to hold this cash in peso or in dollar and/or in a mix, and in case you decide to keep the cash in dollar, is this going to offset the tax effect of your dollar liability? Thank you very much.

Juan Felipe Sottil Achutegui:

That's a good question Eugenio and thank you for it. Let me answer first the easy one. Yes, the private placement is kept in dollars. Our dollar position in cash is quite high at this time, and yes, if that cash were to be held for a long period of time, it will offset our liability position. The reality, however, is that that cash will be converted into buildings over the next, let's say, 12 months, 12, 15 months, and we will be converting those dollars into pesos. As you know, our building costs are basically denominated in pesos. We have not seen any increase—any significant increase in cost per square feet, so I will be converting those dollars into pesos, into buildings, as we quickly stabilize then we–the Company would continue to grow, but for the time being, indeed, my cash position is held in dollars. I'll will turn over to Lorenzo to answer the first part of the question.

Lorenzo D. Berho:

Great. Hi Eugenio. This is Lorenzo Berho again. Definitely we're seeing that our—many of our clients in different industries are still expanding. In the case of the build-to-suit projects and the expansions that we announced this quarter, Nestle expanded their cereal operation under the distribution center in Jalisco. This was an expansion that we were working during the year, and we started construction this month. BRP, as you know, has two facilities, and these expansions were also—were planned during the year, and this is a reflection on how confident they are on Mexico and how confident they are on the competitiveness of their operations in Mexico. TPI is same case; strong demand in their industries, and again, expanding to try to tap the demand from their existing clients. In the end, this is a trend that we are still seeing, even in other regions and other markets.

Looking forward, our pipeline is very strong with existing clients and with future potential clients. It's either for build-to-suit projects, or taking inventory buildings, as they did also this quarter. In the end, that's why, for us it's very important to have the right buildings at the right time so that we can accommodate the needs of some of our clients when they need to expand. Looking forward, we think that we have a very well-defined strategy. We think that the Vesta 2020 Plan is in very good track. We're only a few years ahead of that, and in the end, I think that the demand of the markets and the expansions of our clients will align to the same objective and we will have very good news looking forward.

Eugenio Saldaña:

Thank you very much. Very clear.

Operator:

Our next question comes from the line of Froylan Mendez with JP Morgan. Please proceed with your question.

Froylan Mendez:

Hi guys. Thank you very much for taking my question and congrats on the results. I just have one on—one query. Have you ever had a situation, when a build-to-suit contract expires, have you ever struggled to place that property again in the market? I mean it seems it should be a specialized property, maybe not on the overall standards of the market. Have you had that experience? Can you give us a little bit more color on that?

Lorenzo D. Berho:

Absolutely, I think that–Froylan this is Lorenzo again. Definitely every time we develop a new build-to-suit project, we know that there will be a situation in which we'll have to negotiate with our client in order to either renew the lease and sometimes we do early renewals, and in this case, I think Vesta has a very well-defined strategy. We have local teams in each of the markets which are very close to our clients, and we understand in advance what their requirements will be, so we try to anticipate, and let me tell you, the case of BRP is one of those examples where we not only do an expansion for them in a somewhat specialized building, but we extended the existing lease agreement. In the case of Ciudad Juarez, we extended it for 12 more years starting next year, so the expiration will be 2030.

Early this year, we had a large—we had an early renewal for Nestle, which was expiring in 2018. We renewed early this year, and we extended the contract for additionally seven or eight years. In the end, these are the situations in which we really collaborate with our clients in order to understand their needs in advance, keep on growing with them, and try to mitigate any type of risk of vacating a building. As you can see, we have very high occupancies. We care a lot about our occupancy, and as long as they are good clients, which is the—almost 100% of our clients are great clients—we want to be close to them, and these are the types of advantages that I think a developer or a partner like Vesta has compared to other funds.

Froylan Mendez:

Thank you, Lorenzo, but if it eventually gets vacated, would you require additional cap ex to put it at market standards to lease it to any other tenant, or it hasn't happened yet, or has that situation ever happened?

Lorenzo D. Berho:

Right, and you know what, I think that, yes, we have had those situations in which buildings are vacated, and honestly, I think it's very minor cap ex we have to do. I think it has to do more on the marketing side where we have to find another company. Again, I think the quality of the buildings, regardless of if it's a build-to-suit or an inventory building, the quality of our buildings is—it's very good, even if in some—we care a lot about having buildings where we can accommodate a new tenant easily, even if it's a build-to-suit, so actually, let me tell you that we have been able to accommodate in different buildings different clients, and even increase the rents in some cases, so sometimes it even turns to an opportunity.

Now let me tell you that in the next couple of years, we have very few buildings will be vacated, and honestly, those buildings, in some—some of them are—the build-to-suit projects, they have very minor specialization. In many cases the clients are doing most of the investments. It is sometimes two or three times the amount of the investments that we are doing. We do the shell of the building, and just to finalize on your question, let me just comment that in this weekend we're going to have an event with our—with a broker community, so in the end, we try to understand. We try to be very close to the broker community because, in the end, they are the ones that lead us to define the standard of the buildings, the characteristics of the buildings, in order to have very easy to market properties. We feel very confident on the type of properties we have, and it's a risk that we think it's—might be a minor issue.

Froylan Mendez:

Great. Thank you, Lorenzo.

Operator:

Our next question comes from the line of Pablo Ordóñez with Itaú. Please proceed with your question.

Pablo Ordóñez:

Hi. Good morning. Congratulations on the results. I have two questions. First, on your balance sheet, how much debt do you need to take in order to fund the rest of your growth plan, and where do you see leverage in terms of loan to value in the medium-term? My second question is regarding your land bank. It's at a good size, but it's particularly concentrated. Do you think that you will need to add some land, or are you satisfied with the current land bank? Thank you.

Juan Felipe Sottil Achutegui:

Let me, again, start by the second one. This is Juan Sottil, and thank you, Pablo, for the question. Alan, I'm sorry.

Lorenzo D. Berho:

Pablo.

Juan Felipe Sottil Achutegui:

I'm getting confused. In any case, on the leverage, look, we will increase leverage from the current level to 40%, and over the rest of the Vesta Vision 2020. From the $500 million rough numbers that we have today, we will comfortably increase it to around 750 over the rest of the plan. That's a very conservative leverage. Leverage will be 40% loan to value. Again, that's not a high number. It's nice to feel comfortable, and that and the retained earnings factor that we can have will give us enough flexibility to execute the plan, to build up the Company to around 34 million square feet without the need of diluting during the experience. That was our commitment we've had since 2015, and that's what we will do. We have enough room to achieve that. I can only underline. Really, we have locked in quite a substantial spread between the assets from the liability, and so we're somewhat immune to the—on the current portfolio, to the increase on rates.

Now, on new development, we, of course, have that exposure, but as long as the strong demands remain, and we continue to develop new buildings at cap rates of 10.5%, 11%, the spread is there to sustain the variations on the interest rate market. I really believe that this last funding is really important, and the fixing of all of our debt maturities is very, very important—the fixed rate that we have on all our debt, because of the locked in spread that we have achieved on the current portfolio.

On the other question about land reserves, look, I think that the level of land reserves that we have is quite comfortable given the type of the portfolio. Yes, we have some product concentration. We will buy some land in other markets. We believe that a land reserve of $120 million, given the size of our portfolio, shouldn't surprise anyone, and we will cautiously add land. Land is a raw material that we expect to place within an 18 to 24-month period, and we will add these raw material as we see fit. Clearly there is some markets that we need land, and we will be actively looking for it, and we will be moving the land that we have in the market judiciously and with buildings, and of course, focusing on very high-quality tenants.

Lorenzo Manuel Berho Corona:

Maybe Pablo, it's also important to note—to point out that even if you track our development record, which is what we pointed out in our Vesta Vision 2020 Plan—if you just think about it, when we took the Company public, we were—we had 11 million square feet. Finishing what we have under construction, it will take us to 30 million square feet. Two point five million of development is a very, very minor component of the total portfolio going forward. That means that the development component is very small compared to the size of our current portfolio. I just wanted to point out that, and that represents the opportunities and how consolidated our strategy has been.

Pablo Ordóñez:

Great point. Very clear. Many thanks and congratulations, again, on the results.

Operator:

Our next question comes from the line of Alan Macias with Bank of America Merrill Lynch. Please proceed with your question.

Alan Macias:

Hi. Good morning and thank you for the call. Just a follow-up question on the land bank, if you can provide us what percentage of your land bank has licenses, and if in—during the last quarters, have you seen any delays in the process of obtaining the licenses just related to either stricter environmental regulation, or stricter regulation regarding construction, regulations regarding natural disaster? Thank you.

Lorenzo D. Berho:

Hello Alan. This is Lorenzo. It's a good question. As you well know, we have tried to acquire land, mostly in industrial parks, that already have the infrastructure in place, that already have the zoning in place, and already have the licensing in place, so that we can pretty much acquire the land and start construction and focus on marketing building so that we can lease them up, or to use them for build-to-suit projects.

That's pretty much most of the cases that we have developed. In some of the cases, we have acquired very good land at a very good cost, and in some cases, we need to do all the zoning and licensing too. In this process, we have been very successful because in many cases we try to mitigate many risks. We like to work a lot with local authorities, local governments. In the end, I think we align our interests with the ones from the government's since we all want to attract foreign investment, and we want to generate jobs through the creation of new logistics or industrial buildings, so in the end, we haven't had any major challenges in this regard.

As you know, we have a—today we have a very strong operating portfolio, and that has been the result of a very good and very disciplined development process, so in the end, we're very comfortable, because all of the land that we own today is—has been private land, so it's not that we are converting, for example, the community land (inaudible) to private ownership. It all has been private land, and we think that in the upcoming future we like the strategy of acquiring land inside of industrial parks or land that already has a zoning so that we do not have to struggle too much in that area, and really focus on attracting new companies or growing with our existing clients and develop as soon as possible and try to focus on the, let's say, six to nine-month development period of each of our buildings.

Alan Macias:

Thank you, and just if you can mention if you have seen any cost pressures, either in increase in the price of land, or in the increase of construction materials, for example? Thank you.

Lorenzo D. Berho:

Sure. Definitely land prices have increased, and they have been increasing in the last four years. Nevertheless, we try to identify good opportunities for land acquisitions. Of course, we don't want to overpay for any of them, and I think we have been able to put together a very important strategic land reserve in different markets at very attractive prices, and I think that that combination with our development skills have led us to have very competitive construction costs regardless of some increases in steel and some increases in cement.

I think that it has been offset by the devaluation in the peso, so that—so in the end, we are developing somewhat at a lower cost in U.S. dollars, and if you compare that to the rents, which are pretty much in line, or even higher, than in the last years, returns are very attractive for development. That's why we are close to our development pipeline, because having returns of 10.5%, 11%, 11.5%, are very, very attractive in U.S. dollar long-term leases, and we have strong global companies, so we are very comfortable, still, with our development pipeline.

Alan Macias:

Thank you. Very helpful.

Lorenzo D. Berho:

Thank you.

Operator:

We have no further questions at this time. Mr. Berho, I would now like to turn the floor back over to you for closing comments.

Lorenzo Manuel Berho Corona:

Okay. Thank you very much to all of you for your interest in Vesta, for participating with us in this conference call. We look forward to speaking with you again whenever we release our fourth quarter results of 2017, and in the meantime, as always, if you have any questions, please do not hesitate to contact our Investor Relation Department, and thank you very much. Have a great weekend and goodbye.

Operator:

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.