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Vesta Industrial Real Estate

Third Quarter 2019 Earnings Conference Call

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Eduardo Alvizouri, *GBM*

PRESENTATION

Operator:

Good morning, my name is Robert and I will be your conference Operator today. At this time, I'd like to welcome everyone to Vesta's Third Quarter 2019 Earnings Conference Call. All participants are currently in a listen-only mode, and as a reminder, today's call is being recorded.

I would now like to turn the call over to your host, Ms. Christanne Ibanez, Vesta's Investor Relations Officer. Please go ahead.

Christanne Ibanez:

Thanks Rob, and thanks to everyone for joining our call to discuss Vesta's financial results for the third quarter of 2019. With us today from Vesta are Lorenzo Dominique Berho, Chief Executive Officer, and Juan Sottil, Chief Financial Officer. Following their prepared remarks, there will be a question-and-answer session during which time we will answer your questions.

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Yesterday we issued our earnings press release after market close. This release is also available via the Investors section of Vesta's IR website.

Before turning the call over to Management, I'd like to remind you that this conference call includes forward-looking statements based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with cautionary statements and other information contained within the Company's earnings release dated October 25, 2019 and within the most recent regulatory filings for a discussion of those risks. All figures included herein were prepared in accordance with IFRS and are stated in nominal U.S. dollars unless otherwise noted.

I will now turn the call over to Mr. Berho. Please go ahead.

Lorenzo Dominique Berho:

Thank you, Christanne. Good day everybody and thank you for joining our earnings call. During the third quarter, our Level 3 strategy became fully effective. Due to our new strategy's robust framework and strong fundamentals, we have gotten off to a strong start, which is reflected in Vesta's third quarter results.

As we explained during our investor day last June, the cornerstones of our Level 3 strategy are maintaining and strengthening our current property portfolio, combining investments and divestments to continuously generate value for our fellow shareholders, further bolster investors' balance sheets while also diversifying our funding sources, and strengthening our organization to successfully execute our new five-year strategy.

On the last point, I am pleased to share that our team clearly understands the strategic direction in which we are taking Vesta and they are ceasing the ambitious 2024 goals we have set already identifying short, medium and long-term objectives to achieve them. Our team is showing tremendous commitment to making Vesta a best-in-class self advice and self managed real estate company.

As I noted in my quarterly letter, we delivered on all four components of our strategy during the quarter. Our pre-tax FFO and net asset value per share increased 15% and 10% respectively year-over-year. Leasing activity was solid across our property portfolio. We reached nearly 800,000 square feet of leased space, resulting in occupancy of 95.6% in our stabilized portfolio. Importantly, we achieved this level of occupancy while remaining disciplined, maintaining a strong base of high quality credit worthy clients. Examples of this discipline are three noteworthy companies that are new Vesta tenants, two of which are Fortune 500 companies: FedEx and Home Depot. The other is DSV, one of the world's top logistics companies. Located in Bajio and northern regions, the logistics operations of these clients also illustrate the success of our strategy to diversify our portfolio and include more tenants outside traditional client sectors.

I would like to point out that one of the newly occupied facilities will be devoted to ecommerce operations. We understand very well the importance of the prevailing trends in global logistics, particularly the significant growth opportunities within the ecommerce space and the crucial last-mile location advantage. To be clear, we're not new to this market either and remain a strong player. Other recent additions to our extensive list of logistics tenants includes DB Schenker and Accel Logistics, which joined longstanding clients with logistics operations such as Nestle, Oxxo, BMW, 3M, Nissan, Henkel, and CJ Logistics.

Also in line with our new Level 3 strategy, we are entering new geographic markets and preparing for future demand in the logistics sector. During the third quarter, we acquired new land located in

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Guadalajara, an economically vibrant city and Mexico's second largest. At this site, we plan to build a state-of-the-art Vesta park, one that is consistent with Vesta's clearly differentiated offering; in other words, it will be distinct from existing facilities in this particular market due to our building's hallmark features, high quality and well design. We expect to invest a total of $85 million to develop 1.7 million square feet of leasable space in a privileged location with last mile logistic attributes. Additionally, we have begun construction of three new buildings in Juarez and Puebla totaling 357,000 square feet, another $17.4 million investment in our development pipeline.

During the quarter, we acquired an additional 4.9 million shares. Since we have initiated the share repurchase program, we have bought back over $70 million worth of stock. This latest round of buybacks also increased Vesta's quarterly per-share dividend by 16%.

Asset recycling remains another integral component of our strategy to drive shareholder value, to maintain a robust balance sheet and to enhance financial flexibility for funding new higher returning investments. We demonstrated this capability last May with the sale of eight properties at a significant premium to net asset value and we remain confident that we can successfully complete similar divestments in the future as presented in the Level 3 strategy.

With respect to the macro environment, we remain vigilant about the risks of unstable economic and political environments in the world today. The external threats posed by the U.S.-China trade conflict, which has been impacting global economic growth, diminished automotive trade, a somewhat strained relationship between Mexico and the U.S. that has yet to be resolved, and as a consequence of all of these unclear economic rules under which to operate in this complex international scenario. However, we remain cautiously optimistic and still take a prudent approach to every aspect of our business. Consistent with our strategy, we do not compromise with regard to the quality of the companies we accept as tenants, the lease agreements we sign with them, the high dollar ratio of our revenue base, or our companies' credit ratings.

Lastly, despite exogenous risks that I have referenced, Mexico remains a highly attractive location for foreign investment by global manufacturing and logistics companies that seek competitive advantage, if not more attractive given the geopolitical dynamics that prevail today.

We continually strive to operate more sustainably as another way to differentiate ourselves in the market, so I'm pleased to report that Vesta has been included in the Dow Jones Sustainability MILA Pacific Alliance Index, something that is also personally gratifying as we have a high conviction of sustainable culture in everything we do. We're one of the few real estate companies in the region to be recognize for excellence in environmental, social and corporate governance practices, which clearly evidences our strong commitment to global best practices for ESG.

That concludes my prepared remarks for now. Juan, please go ahead.

Juan Sottil:

Thank you Lorenzo, and good day everyone. Before I address this quarter's financial results, I would like to point out that we adjusted our 2019 guidance to reflect the recent eight property portfolio sale and a delay in income generation at certain new projects. In addition, it is important to explain that without the effect of the portfolio sale, we would have expected to achieve 11% revenue growth versus the 12% at the lower end of the growth range of our previous 2019 guidance. We believe this revenue setback is only short term in nature as our vacant projects are beginning construction with a robust pipeline and a strategy to expediently sign leases for the pending vacancies. In the meantime, we are cautious in our development efforts in markets with lower absorption levels than in the past. We believe these lower levels follow the accelerated growth that some markets have experienced in more recent years.

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With that said, we now expect full year rental revenues to grow between 7.5% to 8.5% versus prior guidance of 12% and 14%. We are also lowering slightly our previously forecast NOI margin to 95% from 96%, and our EBITDA margin to 84% from 85%.

Returning to our third quarter results, I'll start with the top line. Our third quarter revenues increased nearly 6% year-over-year to $36 million mainly due to higher occupancy, which rose to 92.6% from 91.2% last year, and to a 3.6% increase in rent per square foot on a healthy supply dynamic in our markets. Revenues were partly offset, among other items, for a $2.6 million decrease in rental income which was related to expired leases that were not renewed during the quarter. Lastly on top line, the percentage of our revenues denominated in dollars expanded 150 basis points to 86.5% compared to the third quarter 2018.

Our leasing activity was a solid 798,000 square feet, of which 480,000 was new leases with current as well as new international clients such as those highlighted by Lorenzo. Three hundred and fourteen thousand square feet was lease renewals, bringing maturing GLA to only half a percent in 2019 and 6.6% next year. At the end of the quarter, our weighted average lease maturity profile was five years, which remains the highest in our sector.

Moving to our main expenses in the quarter, Vesta operating costs increased 23% to $1.8 million, reflecting higher costs in occupying properties which rose 31% to $1.7 million. That results to a net operating income which increased nearly 5% to just over $34 million. The corresponding margin decreased 91 basis points to 95.2% due to higher costs in related properties generating rental income. Our administrative expenses increased a little over 15% to $4.5 million mostly due to higher employee benefits.

Vesta EBITDA rose 4.3% to $30 million while the margin contracted 130 basis points to 84.4% because we generated less rental income following the sale of the property portfolio last May. At the same time, our administrative expenses considering unadjusted revenues remained constant. This also had bearing on our full year guidance.

Total other income decreased 70% to $3.84 million. This was mainly the result of a smaller gain on the reevaluation of Vesta investment properties, roughly $14 million versus $19 million in the last quarter, and a non-cash foreign exchange loss of $1.5 million versus a gain of $3.6 million. At the same time, our interest expenses fell 7% to $9.1 million. This year-on-year decrease reflects lower expenses from the refinancing of the new debt. This brings us to pre-tax income of $33 million, which we paid taxes of $20.6 million versus $2.3 million last year. While our current tax declined 58% to $6.4 million, there was a net change in deferred tax liability on assets of $27 million. Higher income taxes couple with a loss of $0.4 million related to the valuation of derivative financial instruments and a gain of $0.02 million related to exchange difference in translated other functional currency operations reduced our total comprehensive income to 77% to $12.07 million. Our pre-tax FFO increased nearly 10% to $21.12 million while our FFO attributable to shareholders roughly quadrupled to $15 million.

Investments during the third quarter totaled $35.9 million, primarily payments for the construction of new buildings in the North, Bajio and central regions. The total value of Vesta's investment portfolio increased 2.3% to $1.9 million—billion, I'm sorry. At the end of the quarter, total debt was $714 million, of which less than $1 million is short term liabilities. The secure portion of our debt is just below 50%. Importantly, all of Vesta debt denominated in dollars has a fixed rate average interest rate of 4.8%. As a reminder, we do not have any major debt due until 2024. Our debt leverage remained at a healthy level of 5.1 times net debt to EBITDA and a loan to value of 35%.

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Our focus remains on efficient and accretive capital allocation. As Lorenzo noted, our NAV per share increased 10% to $2.30 per share or a three-year CAGR of 8.9% in dollar terms. The increase was partly due to the 4.9 shares that were bought back during the quarter and it also resulted in the 16% increase of our quarterly dividend, which was $0.43.

Turning to occupancy, the level in our satellite portfolio increased 20 basis points compared to the second quarter 2019 to 95.6%, while occupancy in our same store portfolio was essentially unchanged at 98%. Sequentially, Vesta's total portfolio expanded roughly 74,000 square feet to 29.3 million square feet of 182 high quality industrial properties. Total vacancies fell to 7.4 from 8.8 on a quarter-per-quarter basis. At the end of the quarter, we have 8,013 square feet of inventory and build-to-suit facilities under construction in Juarez, Puebla, San Luis Potosi, and Tijuana, and land reserves of 40 million square feet which increased 7.3% sequentially.

Operator, this concludes our prepared remarks. Please open the line for questions.

Operator:

Thank you. We will now be conducting a question-and-answer session. If you'd like to ask a question, please press star, one on your telephone keypad and a confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants that are 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.

Our first question comes from Eduardo Altamirano with HSBC. Please proceed with your question.

Our next question comes from Vanessa Quiroga with Credit Suisse. Please proceed with your question.

Vanessa Quiroga:

Thank you. Hi Christanne, Juan, Lorenzo, how are you. My question is regarding any views on softer markets that you can share, maybe those that have been affected by the strike by GM employees in the Bajio region. Can you comment what's the latest updates in those markets?

The other question that I have is the reason for your lower margin guidance. Thank you.

Lorenzo Dominique Berho:

Hola Vanessa, thank you very much for being on the call. This is Lorenzo. I will answer the first question and probably Juan can elaborate on the second one.

Clearly we have seen that in some of the markets have a very—had a lot of growth in the last cycle, in the last five years. This is particularly in the Bajio region with growth over—in some cases even at double-digit growth in terms of demand and in terms of absorption. What we have been seeing in the last probably three or four quarters is that some of these markets are taking a little breath in terms of how quickly they can keep on growing, so this—and this has been mostly in Queretaro and Guanajuato. Nevertheless, we see still a very robust pipeline, that it's probably just taking a little longer to close, and in addition to that we see that the real estate fundamentals are still pretty good in those markets. So, even that we have had three to four quarters which were at a lower pace than historically, we still see that there could be an opportunity looking forward to increase demand from different sectors.

I pointed out a particular project that we closed with FedEx in the Vesta Park Queretaro. This was our first tenant in the region—I'm sorry, in this project, so we think that this reflects the opportunity in Queretaro to

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attract tenants from logistics sector, automotive sector, as well as aerospace sector as leading industries for this project.

Regarding GM, definitely there is still a strike—there is a labor strike. I don't know if it's globally or it's only in the U.S. and Mexico, but I think it's mostly coming from the U.S. Definitely this has taken longer than expected. Nevertheless, I think that we have long term commitments with our tenants. Our tenants are operating not only for GM but they are well diversified towards other OEMs, not only Mexico but even in other places, so I think that for that, they will at some point renegotiate, and I think that these companies or these facilities they have in Mexico are incredibly competitive, so therefore I think it's in the benefit of GM to get into an agreement as soon as possible.

Juan Sottil:

Vanessa, regarding your guidance question, I think there—we changed guidance for two main reasons. The first one is easy to understand. We sold a portfolio last May and the impact of the revenue that we forego for the sale of that portfolio implied a lower revenue vis-à-vis the 12% guidance, 12% to 14% guidance that we gave last October.

On the other hand, we also have certain projects that we forecasted to start generating income during the year, and as Lorenzo pointed out, there is a slight delay on the stabilization of these projects. We have a very healthy pipeline of clients and we expect to close these leases in the forthcoming months.

I have to point out that if we had not sold the portfolio, our achievement of revenue growth would have been 11%, which is quite a solid number on growth on a very large portfolio that we have right now.

Vanessa Quiroga:

Very clear answers, thank you Juan, thank you Lorenzo.

Lorenzo Dominique Berho:

Gracias.

Juan Sottil:

Thank you.

Operator:

Our next question comes from Adrian Huerta with J.P. Morgan. Please proceed with your question.

Adrian Huerta:

Hi, good morning everyone. My question has to do with the land bank that you have in Queretaro and Aguascalientes where you have land for somewhere around 500,000 square meters of potential GLA on each. You haven't started any construction in any of these two markets. What are your views on these two markets and if you are planning to start construction in any of these two markets any time soon? Thanks.

Lorenzo Dominique Berho:

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Thank you, Adrian, for being on the conference. We have two particular projects in Queretaro and in Aguascalientes. The reason of developing these two projects, Vesta Park Queretaro and Vesta Park Aguascalientes, is because we ran out of land in both markets. As you remember, we have been very successful in Queretaro once our focus was in the Park Industrial Queretaro. We acquired land probably more than 10 years ago and we have fully developed those projects, that's why it was important for us to acquire land, have the infrastructure in place so that we can develop a five-plus year project, and that's what we have in Vesta Park Queretaro and hopefully you can visit it, because that's going to be an iconic project for Vesta in the future. That's 100 hectare project, we have developed the infrastructure, we have a fantastic substation and energy is an important element today, and we have developed the first two inventory buildings.

We will be very cautious with the next inventory buildings or spec buildings. As long as we keep leasing up what we have today, we'll start another one, and that's why, as I mentioned, we have been taking a halt on that particular project until we lease up more space in Queretaro, which is in accordance to market, and I think that's a disciplined approach to go.

In the case of Aguascalientes, we actually had the inauguration of our project last week. This is also a roughly speaking 90 hectare project in Aguascalientes, and we were able to buy the land in the last two years. It took us a while to acquire land at a good cost. We already have the infrastructure and we already have two buildings which are on a lease-up stage. The reason of doing this particular project which is also another five year-plus project is that we are fully leased and we have fully developed the first phase of the DSP park in Aguascalientes, which is right next to the new—to the Nissan plant and right next to the new Mercedes Daimler and also Infiniti plant, so that's why for us it was important to acquire land, have the infrastructure, and it will be a five year-plus project.

Now having said that, we want to be also very cautious on how fast we develop, and we want to be closer to where the market is. If there is demand, we develop more; if it takes us a bit longer, we're going to be very disciplined and very cautious, and that's exactly what we have been showing in both of these projects.

Adrian Huerta:

Thank you, Loren.

Lorenzo Dominique Berho:

Thank you.

Operator:

Our next question is from Eduardo Altamirano. Please proceed with your question.

Eduardo Altamirano:

Hi all, thank you for taking my question. Just a follow-up on some previous questions. Are you seeing an increase in demand for manufacturers based in Asia; in other words, are you seeing or finding the effects of the trade war to your benefit or is it a non-issue right now? The second one is would you be considering an acceleration of your development plans, that is to say a return to more spec buildings, or are you comfortable with your current strategy?

Lorenzo Dominique Berho:

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Thank you, Eduardo. Could you just please repeat the last part of your question?

Eduardo Altamirano:

Would you be considering an acceleration of your development plans, in other words a return to spec building or adding increased spec buildings?

Lorenzo Dominique Berho:

Great, thank you, Eduardo, for being on the call. I will probably start with the second question. I think that we have a very well-defined strategy which is based on market fundamentals and it's based on a lot of discipline, and I think that's what we have been working together with our investment committee and that's what we want to keep on doing looking forward. We like to do spec buildings. They're profitable, we can have great companies, and these are very flexible buildings. Nevertheless, we develop them as long as we lease up whatever we have currently.

As you might see, our portfolio, same store portfolio is pretty much very good occupancy, above 98%, which means that there's a couple—there's only—the buildings that we have available are the brand-new buildings that we have developed in the last quarters, which are in the lease-up stage, and these are the brand-new buildings, so we don't want to increase our spec building strategy. We want to maintain the same one and we're going to keep on developing as long as we lease up what we have. That's for the second question.

Regarding the first one, we are very close to trying to understand what are going to be the drivers towards new companies, international companies coming into Mexico. You asked regarding the Asian companies. We have seen some—definitely some opportunities in Mexico from Asian companies. We have one recent example of a company that shut down operations in Asia and recently opened something with us in the north part of Mexico, in Ciudad Juarez. But we also want to be cautious because we don't know if this is a major trend or if this was a one-off transaction. I think that the evolution of the trade situation between the U.S. and China will keep on evolving. We're going to find out more. Definitely Mexico makes a lot of sense for foreign companies, but you know, I think that it doesn't necessarily mean that all of the companies will only come to Mexico. There will be some, we're going to be close to those opportunities, and definitely I think that what we want to do is just be close to the companies that—to any companies, not only the ones that change their strategy but also the ones that have already set up their strategy towards Mexico and want to keep having expansions and want to be still competitive producing out of Mexico.

Eduardo Altamirano:

Excellent, thank you very much. I appreciate it.

Operator:

As a reminder, please ask one question and one follow-up at a time. Our next question comes from Francisco Suarez with Scotiabank. Please proceed with your question.

Francisco Suarez:

Yes, hi. Thank you. You mentioned that you are investing in a very interesting plot of land in Guadalajara. I was wondering if you can share a little bit more of what you think is happening on that work particularly, mainly if that piece of land is near the X corridor how near downtown Guadalajara is, and if that is actually a trend that we would see forward from you guys. I mean, you've been seeing much more in logistics in

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general, in last mile features on your buildings. Anything you can share with us at this moment, that would be helpful, thank you.

Lorenzo Dominique Berho:

Gracias Francisco, and thank you for being on the call. Yes, the piece of land that we acquired in Guadalajara is right next to the Atlas golf course, which is very close to the most important logistic corridor. This is a very good site, very centralized in the city, and definitely has important attributes towards logistics and particularly if the trend continues, mostly towards proximity last mile opportunities.

What we are seeing in this type of market, it's an opportunity to develop more for logistics, particularly because of the size of the city, because of the urban dynamics, and that's why finding these type of opportunities is going to be very good for our strategy to diversify our portfolio, which means that we still want to keep the leadership in terms of being close to the other sectors, to the other industries, which are the ones that are really making—being an important part of the growth in Mexico, and second to that, we think that there could be also great opportunities on the logistics sector, and that's why we decided to do this project in Guadalajara. This is going to be a project that could take us roughly speaking four years to fully stabilize, and we like the site, it's 30 hectares approximately, and we're going to be developing 1.7 million square feet. So, if you have visited some of our other Vesta parks, I think this is very replicable in terms of size, in terms of the time that we're going to be developing it, and—but definitely I think that this will have its own characteristics so that we can really show the market in Guadalajara that there's an opportunity to increase the quality of the buildings, increase the quality of the industrial parks, and for that increase the service towards our clients.

Francisco Suarez:

Perfect, congrats. Thank you.

Lorenzo Dominique Berho:

Thank you.

Operator:

Our next question is from Victor Tapia with Bradesco. Please proceed with your question.

Victor Tapia:

Hi, good morning. Good morning Juan, good morning Lorenzo. I have two questions here. First one, I don't know if you guys already answered this or if someone already asked it, but we have been seeing some news regarding a slowdown in the automotive industry, mainly in the Bajio region, and in the Bajio region is where you guys have the higher vacancy in the portfolio. Five out of the 10 top tenants for Vesta are in the automotive industry, so I want to get color on how this could negatively affect vacancies going forward. This is my first question.

The second question regarding accounts receivables, we saw that accounts receivables with more than 60 days late significantly increased since the end of last year. I also wanted to get a little bit more on details on why that is happening and so you guys should continue provisioning a higher amount for these late receivables. Thank you.

Juan Sottil:

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Let me start with the second question, Victor. Thank you for being on the call. Look, the policy of receivables, we're very stringent. Any receivable that is over 90 days is fully reserved. I think that's very prudent. Second, we're one of the—we're very open in our financial statements and we provide a lot of detail on all of our balance sheet and income statement items, and I'm very glad that we opened our receivables so that you can fully understand the strength of our client base. Yes, there's a little bit of delay in some of the clients. I don't think this is a trend or anything, I think it's just part of the economic cycle. We have good clients, we have very strong relationships with them, and I don't think that this is a particular point of—a particular worrisome point on our balance sheet. But again, we are stringent, we will reserve any receivable that is over 90 days, and that's in accordance to the best practices of any real estate company globally.

Lorenzo Dominique Berho:

Great. Victor, thank you for being on the call. Regarding your first question, let me try to address the situation or how we are viewing the market but let me probably explain it more on the particular item which is regarding vacancy.

I think that one of the main characteristics of our existing portfolio, which is already at almost 30 million square feet, is that we have a very well maturity profile and a very well kept portfolio in terms of our leases. Remember that we have corporate guarantees in many of our leases, and if you talk about a particular sector, for example automotive industry, it's mostly about the term of the leases that we have. We have very few expirations coming in the next months. Actually, if you consider only 2020, I think it's less than 4% or—yes, less than 4%, the expiration, the maturity profile, which is a reflection of how well we have been able to impact or to extend the lease agreements that we have. So on that regard, I see really a lower risk of increasing vacancy of our portfolio. This is a very important objective.

Secondly, the rhythm of growth for the automotive sector in the Bajio region, I think that that's why for us it's important to keep on having a well diversified portfolio. The automotive industry represents roughly one third of our portfolio, but we have the other two-thirds which is still expanding. We're increasing our portfolio in other industries such as logistics, electronics, we have also medical device industries, consumer goods, so in the end I think that we are very open to keep diversifying so that we don't only rely on one particular industry, and that has been a key component to our existing portfolio, which we want to keep shaping the same way into the future.

Victor Tapia:

That's very clear, thank you.

Operator:

Our next question comes from Alan Macias with Bank of America. Please proceed with your question.

Alan Macias:

Hi. Good morning. Thank you for the call. Just a quick question on security issues. Any issues that have appeared in any of the regions that you operate? Do you foresee that you have to increase expenses in this—in security? Thank you.

Lorenzo Dominique Berho:

Thank you, Alan, and probably this is a good time to explain a bit how we differentiate our industrial parks, particularly the Vesta parks. We know that security is an important issue pretty much all over

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Mexico and this is not new. This has been for several years, and that's why the way that we have designed and built our industrial parks is in a way that we can add more security to our existing clients. That's why all of them in the Vesta park, some of their main considerations is that they are closed gated parks, communities where they can not only have their facilities inside but they can also have in some cases business centers, in some cases they also have some sports amenities and other sorts of amenities. We have been very cautious in that regard.

It does—throughout the whole supply chain, there is a lot of risks in terms of security from trucking to parking to whatever ties between the final user and the facilities, but what we can do and what we can achieve, I think that we have been able to define a good security system in our projects, and that's something that we're going to keep on doing to enhance the security, even—because we don't know exactly how security will evolve in Mexico. But for our projects, I think this is a very important part of—an important differentiator, and I think that our tenants, this is one of the reasons they decide to be in a Class A, state-of-the-art industrial park vis-à-vis being openly in any other industrial area, so to say.

Allan Macias:

Thank you.

Operator:

Our next question comes from Andre Mazini with Citigroup. Please proceed with your question.

Andre Mazini:

Good morning Lorenzo, Juan and Chris. My question here is on the total rental revenues that you guys disclosed by region, right? If you look at Queretaro and Toluca, those are the only two regions that had revenues decreasing year-over-year, and I don't think that's explained by occupancy. Queretaro actually had an increase in total occupancy so I'm wondering is this something related to where market rents are, you had to mark down some properties to market rents which were likely above market rents, am I correct in this read or it's something else? Thank you.

Lorenzo Dominique Berho:

Okay, I'm looking at Toluca. Hello, thank you for being on the call. I'm looking at Toluca and I think the decrease in revenue is mostly because we sold properties in Toluca and Queretaro, so because of the portfolio sale, this is why we had the highest impact on our guidance was because of the portfolio sale. Secondly, it was basically in Queretaro and Toluca, so really nothing else has changed. We have a very good retention rate in terms of renewals. We have been able to actually renew at higher rates in dollar terms, so we have been very—we have been very—the market is very good on that regard. There is no need to give rate, rent abatement. I think that that impact that you're seeing on the financials is because of the sale of the portfolio.

I think it's important to say that globally the total portfolio, we have been able to increase year-over-year and quarter-over-quarter the rental rate, the average rental rate per square foot, so we have been—in dollar terms, so I think that in that regard, that's another signal that the market is still—that the market fundamentals are still very strong and we're very disciplined in really trying to be—trying to increase the rents as much as we can and extend the lease agreement.

Andre Mazini:

Perfect, very clear. Thank you.

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Lorenzo Dominique Berho:

Thank you.

Operator:

Our next question is from Eduardo Alvizouri with GBM. Please proceed with your question.

Eduardo Alvizouri:

Hi guys, thank you for the call. My question is regarding the market overview. We have been seeing healthy equilibrium between supply and demand in industrial buildings, showing high occupancies consistently. How long do you think this expansion phase will last? I mean, do you believe economic and political volatility may affect this balance in the short term, in particular regarding the northern part of the country and in particular for Vesta the Tijuana and Juarez properties? Thank you.

Lorenzo Dominique Berho:

Thank you, Eduardo, for being on the call. I think that real estate is about cycles and definitely the explanation of cycles is that things could change eventually. That's why we are very cautious on analyzing how the cycle is evolving, first of all in each of our markets so that we can define a strategy for each of the markets, and secondly what are the exogenous factors that may impact our markets. For example, the economy in the U.S. has an important impact or the economy even in Mexico for certain industries. So, all of that, I think, are the ones that really mark how the demand could come in most of the markets.

As of today, we have seen in the last—in the last cycle that the markets are still very healthy and that other developers have been also disciplined in how much they develop in spec buildings, so having vacancy rates for example in the range of 2% to 5% in most of the markets, these are very healthy numbers. These are at record low, so we're going to be tracking this very closely. This is exactly what we do.

Having local presence for us is very important. As you know, we have regional offices in most of the markets which has helped us to have a leading position, but this also helps us to have very deep market intelligence that can help us to make decisions on where we want to keep investing, where we want to take a break, and where we want to—and how we want to develop a strategy for the short, medium and long term.

Eduardo Alvizouri:

Thank you

Lorenzo Dominique Berho:

Thank you.

Operator:

As a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. One moment please while we poll for questions

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There are no further questions. I'll now turn the call back over to Mr. Berho for closing remarks. Please go ahead, sir.

Lorenzo Dominique Berho:

Thank you, Operator. Thank you very much everybody for being on the call. We look forward to being close to you during the quarter. This is going to be the last quarter of the year, and we hope to stay in touch with you. If you have any further questions, please contact our IR team. Thank you and goodbye.

Operator:

This concludes today's conference. You may disconnect your lines at this time and we thank you for your participation.

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