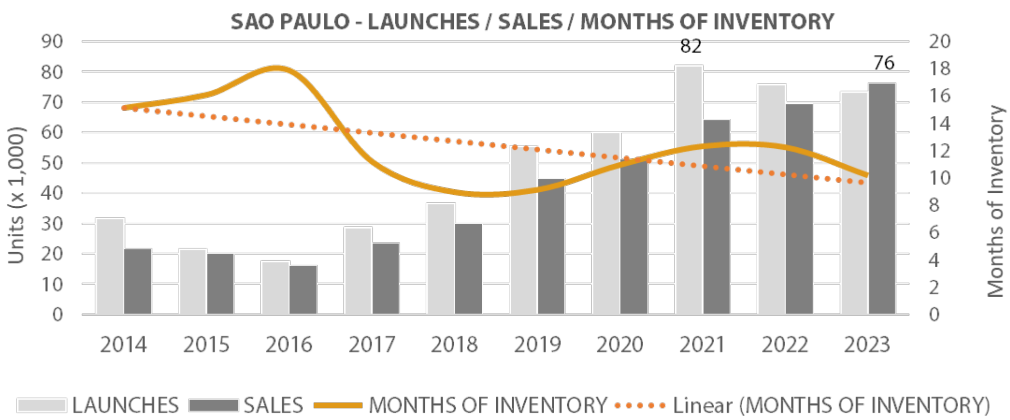
Introduction

In this annual residential sales report, we delve into the demand and supply fundamentals of Paladin Realty's target Latin American markets, most of which have shown remarkable resilience and growth over the past year. Despite various challenges, the housing markets in these cities have thrived, demonstrating the robustness and potential of Latin America's residential sector, reinforcing for-sale housing as a cornerstone of Paladin's focus in the region.

Brazil: Latin America's Largest and Strongest Market Continues to Outperform

2023 was another record-breaking year for residential sales in São Paulo, and the fourth such consecutive year, as 2020, 2021, and 2022 also set records at the time. The city's 76,145 sales last year eclipsed 2022's record by a healthy margin of 10%[1]. Launches however, while high at 73,249, were down 3.2% vs. 2022 and down 10.5% from the record supply that came in 2021. As a result, unsold inventory ended the year at 64,634 units, 13% below the market's peak which occurred in Dec-22. This "stock" translates to 10.2 months of inventory, considering São Paulo's robust absorption levels, and a healthy number, as the 10-year average stands at 12.4 months. It is important to note that only about 2% (±1,000 units) of this stock is "standing inventory" ready to be occupied; the rest is either under construction or in pre-development. The following chart illustrates the evolution of São Paulo's launches, sales, and months of inventory over the past decade:



Looking at the demand drivers for housing, we can understand why the performance has been so strong in recent years:

- Economic Growth & Employment – Brazil's economic growth has consistently surprised to the upside since the pandemic, growing 5.0% in 2021, 2.9% in 2022, and 3.1% in 2023[2]. As such, Brazil's unemployment rate has been on a strong downward trajectory since peaking at 14.9% in Mar-21, finishing 2023 at just 7.4%, the lowest figure since 1Q15[3].

- Consumer Confidence – The seasonally adjusted FGV-IBRE, Brazil's Consumer Confidence Index has been on a strong upward trajectory since the COVID-induced depths of 2020 (58.2), reaching its highest point since 2014 in Sept-23 (97.0)[4].

- Interest Rates – Ultra-low interest rates no doubt helped sales in 2020 and 2021 reach all-time highs, but it has been interesting to see that the increase in the SELIC (Brazilian Federal Funds rate) from a historic

[1] Sindicato das Empresas de Compra, Venda, Locação e Administracão de Imóveis de São Paulo (SECOVI)
[2] International Monetary Fund
[3] Statista.com
[4] Trading Economics

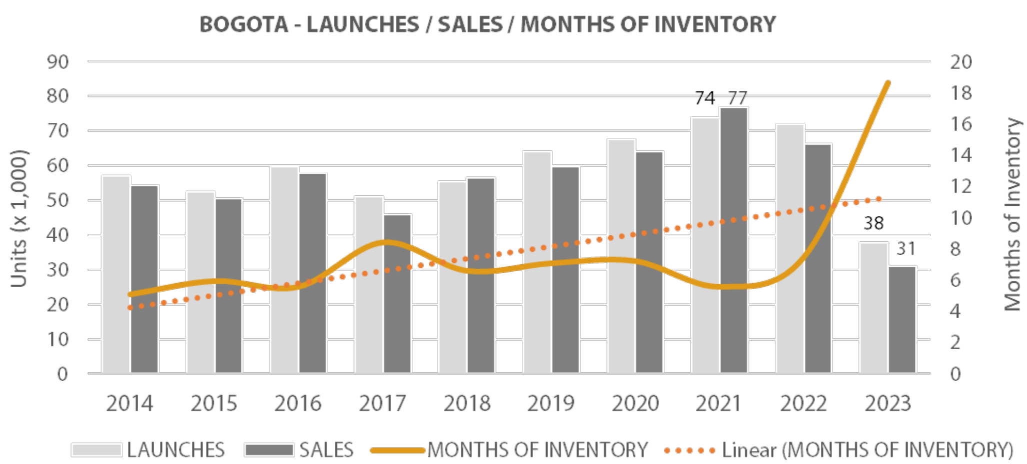
low of 2.0% in 2020/2021 to 13.75% by Aug-22[5] did not appear to have much of an effect on demand. The primary reason is that mortgage interest rates do not have a high correlation with the SELIC, due to nature of the cost of capital for savings accounts (SBPE) and government social security funds (FGTS), which serve as the pool of capital for most mortgages; the 1175 basis point increase in the SELIC referenced above only pushed average mortgage rates about 300 basis points, from the 9% to 12% range[6].

- Government Policy – The return of President Lula da Silva, creator of the *Minha Casa Minha Vida* housing subsidy program, no doubt boosted launches in 2023, with an 18% increase in units launched vs. 2022, increasing the affordable segments market share from 44% in 2022, to 50% in 2023[7]. Former president Bolsonaro did little to promote housing as a government priority, even changing the name of the affordable program to *Casa Verde e Amarela* in an attempt to erase the legacy of one of Lula's successful programs.

Home prices were in line with inflation in 2023, as the IPCA index closed the year at 4.5% and home prices nationwide increased 5.1%. São Paulo was just below that national average (4.7%), while Rio de Janeiro's home prices increased just 1.4%, 310 bps below inflation. The greatest increase among capital cities was in Maceió (16.0%), a tourist driven city in the northeastern state of Alagoas[8].

Colombia: Demand Hampered by Government Policy and Mortgage Rates

Bogota was a different story in 2023, with sales totaling just 30,993 units, down a staggering 53% from 2022, and 60% from the all-time high in 2021[9]. New product launches followed suit, as 37,799 new units of supply were added, down 48% year-over-year. Unsold inventory closed the year at 48,203 units, representing 18.6 months, 2.5x higher than the 7.5 months registered at the end of 2022. As noted above for Brazil, of this unsold inventory, only 2,005 units (4%) are "standing inventory" of completed product.



The reasons for such underperformance were a clear combination of:

- Government Policy – Controversial leftist President Petro's new housing administration paralyzed the housing industry with confusing changes to the Mi Casa Ya government subsidy program that are instrumental to the system; priority was given to smaller municipalities with greater perceived need than to the large cities where the majority of homes are built, and the lowest income residents, who don't earn enough to qualify for mortgages.

- Mortgage Rates – Interest rates for mortgages spiked from a 10-year average of 11.3% to a high of 17.8% in 2023[10]; there is a strong correlation in Colombia between reference rates and mortgage rates.

[5] Trading Economics
[6] Sistema Brasiliero de Poupança e Empréstimo (SBPE), Bradesco
[7] SECOVI
[8] FipZap
[9] Galeria Inmobiliaria
[10] Banco de la República

- Consumer Confidence – Confidence in Colombia (CCI) is measured in terms of positive numbers (20-year high of +38.8 in Aug-2010) and negative numbers (20-year low of -41.3 in Apr-2020)[11]. Confidence levels did increase in 2021 from the depths of COVID, but the election of Petro in mid-2022 cast a shadow over the direction of the economy and sent confidence levels back below zero; prior to his election the measure read +2.9 but fell sharply to -22.3 by the end of 2022. In 2023 sentiment did improve but the CCI still registered -17.3 at year-end.

Prices in Colombia grew by 12.4% in 2023, 312 bps above inflation of 9.3%[12]. Prices tend to track inflation quite closely as price caps for low-income housing (VIS, *Vivienda Interes Social*) are annually indexed to the country's minimum wage; the minimum wage is adjusted every January based on the prior year's inflationary measures. The minimum wage adjustment made in Jan-2023 was 16%, setting the stage for the year's VIS price increases. VIS products account for roughly 70% of all sales[13] and thus have a strong impact on the overall market.

Mexico: Supply Constraints Keep Demand Strong

While consistent long-term data for Mexico City has been more difficult to attain, it is clear supply has been substantially reduced since 2018: annual building permits issued in Mexico City averaged approximately 1,280 from 2014 to 2018, but since then have averaged about 550 (-57%)[14]. This drastic reduction in supply is due to several factors:

- The election of President Lopes Obrador in 2018 and the policies of his Morena party – an approval moratorium was immediately instituted on real estate projects in Mexico City exceeding 10,000 square meters of built area; even smaller projects not subject to this moratorium have seen more bureaucracy and delays in obtaining approvals.
- The COVID pandemic put many small developers out of business.
- Many major developers are shifting focus to nearshoring and the industrial market in the northern states.
- INFONAVIT, the major mortgage lender in Mexico, adjusted its point system, making mortgages more difficult to obtain; it also shifted focus from mortgages on new homes to existing homes and loans for the physical improvement of existing homes.

This bodes well for the future with substantial pent-up demand, as several positive factors line up:

- Economic Growth & Employment – Mexico's economic growth has been among the strongest in Latin America in recent years, growing 5.8% in 2021, 3.9% in 2022, and 2.8% in 2023[15]. As such, Mexico's unemployment rate has been below 5% since 2011, finishing 2023 at just 2.9%, its lowest reading since 2012[16].
- Mortgage Rates – For the last 10 years interest rates for mortgages have been remarkably steady, averaging 10.6% with a low of 10.2% in 2020 to a high of 11.4% in 2023[17]; despite the recent high, the predictability and consistency of mortgage rates is a tailwind for housing demand. The lack of correlation to Mexico's reference rate makes mortgage credit even more attractive relative to other products; the reference rate increased 475 basis points from a pandemic low of 5.5% to 11.25% at year-end 2023, while the mortgage rate increased just 120 basis points over the same period[17]. This is largely due to the fierce competition between banks for banking clients to whom they can cross-sell insurance and other financial services.

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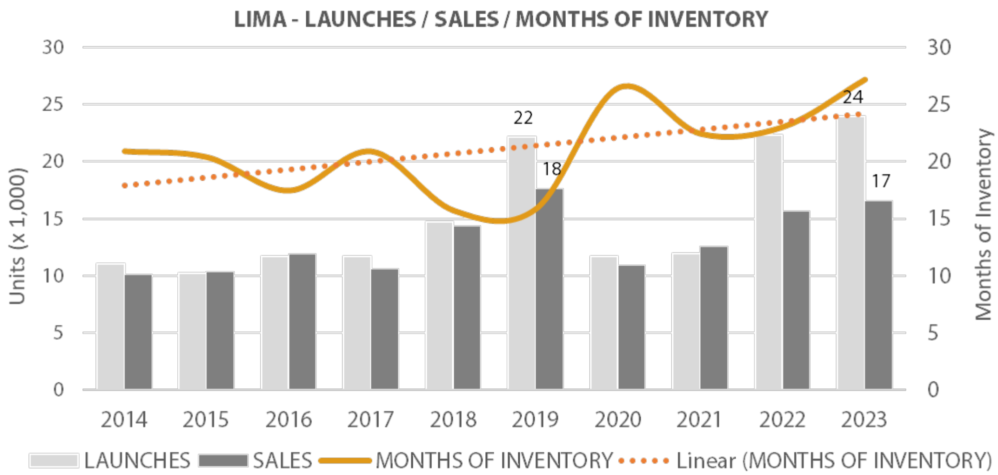
[11] Trading Economics
[12] Departamento Nacional de Planeación (DANE)
[13] Galeria Inmobiliaria
[14] Secretaria de Desarollo Urbana y Vivienda (SEDUVI)
[15] International Monetary Fund
[16] International Monetary Fund
[17] Bank of Mexico

- Consumer Confidence – Confidence levels in Mexico (ICC) finished 2023 at 46.8, following strong and steady improvement since a pandemic low of 31.2 in 2Q20; this current level is 15% above the ICC's 10-year average of 40.8[18].

Peru: Resilient Demand Despite Ongoing Political Turmoil

Lima's housing market had a strong 2023, with record high launches and the second highest unit sales total on record. Sales nationwide totaled 16,549 units, up 5% year over year, and 27% above its 10-year average of roughly 13,000 units[19]. Launches hit an all-time high of 23,905 units, 7% above 2022, and 58% higher than the 10-year average. With two consecutive years of record launches, the concern going forward is unsold inventory – roughly 37,500 units remain unsold, translating to a record-high 27.2 months of inventory at current absorption levels. This is 29% above the country's 10-year average of 21.1 months; as shown below the trendline points higher.



Factors that contributed to the strong year were a combination of:

- Employment – Despite lackluster growth (just 1.1% in 2023) and Peru's incessant political turmoil (six presidents in last six years), the unemployment rate has continued to fall since its pandemic high of 13.0% in 2020, to 7.6% at the end of 2023, a level on par with the country's 10-year average[20].
- Mortgage Interest Rates – Although up 200 basis points since lows in 2020, the average mortgage rate in Peru in 2023 was 9.1%[21]; not cheap, but only 100 basis points above the country's 10-year average.
- Inflation Rate – Peru's IPC inflation index started the year at 8.7% (highest since 1996) but by year-end it had fallen to 3.2%[22], boosting purchasing power.

Sales relative to population in Peru have been consistently below that of other countries for as long as we have been keeping track. Annually Lima sees one home sold for every 677 residents, while in Sao Paulo there is one sale annually for every 297 residents, and the figure is even more impressive in Santiago and Bogota, where there is one home sold per year for every 210 and 208 residents, respectively[23].

One reason, we believe, is the structure of the mortgage system – buyers in Peru get mortgages upon pre-sale, often long before their home is complete, requiring them to spend their disposable income on their current housing solution, as well as a mortgage on their pre-purchased home. Thus, pre-sales are lower and the homebuilding system operates on a longer timeline.

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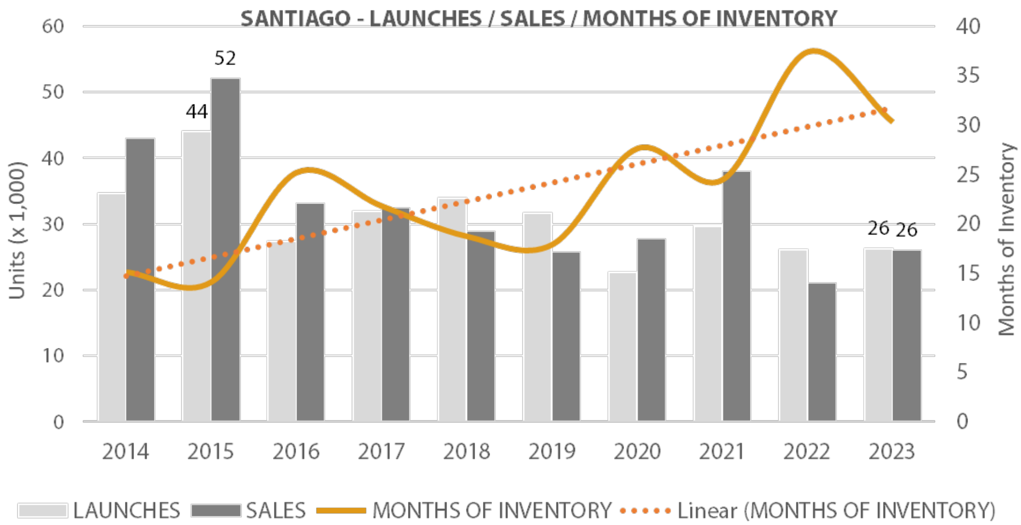
[18] Trading Economics
[19] Asociación de Empresas Inmobiliarias del Perú (ASEI)
[20] International Monetary Fund
[21] Superintencia de Banca, Seguros y AFP (SBS)
[22] Banco Central de Reserva del Perú
[23] Paladin Research

Chile: Steady Demand, but Still Below Long-Term Average

The housing market in Santiago had a relatively good year in 2023, but still subdued when compared to a longer horizon. Sales nationwide totaled 26,042 units, a 24% increase over 2022, but still 21% below the city's 10-year average of roughly 33,000 units[24]. At 26,205 units, launches were on par with 2022, but 15% lower than the 10-year average. While inventory levels were on par with 2022, the increase in absorption has brought months of inventory down from an all-time high in 2022, to 30.3 months. This is 30% above the country's 10-year average of 23.3 months.



One factor that has impacted sales over the last couple of years is the economic and political uncertainty following the election of Gabriel Boric in December 2021. Policy uncertainty, political polarization, reform expectations, and mass protests have impacted consumer confidence; confidence levels dropped from 37.6 in Dec-21 to a low of 21.5 by mid-2022, the lowest in recorded history (excluding the pandemic low in 2Q20)[25]. The 10-year average for residential sales up to 2021 was approximately 33,000 homes per year, but that of 2022-2023 is just 23,500, a decrease of almost 30%[26].

Outlook for 2024: Improving Demand Drivers & Pent-Up Demand

Paladin remains bullish on Latin America's for-sale residential market in 2024, expecting the major demand drivers to continue to improve and one-off shocks from 2023 to ease:

- Mortgage Interest Rates – All of the target markets are in the early stages of easing cycles, that while not always directly correlated with mortgage rates, does help. Brazil has already cut the SELIC 200 basis points to 11.25% (potentially heading to 9% by year-end); Peru has cut rates six times since 3Q24 totaling 150 bps; Mexico just made its first cut in Mar-24, a symbolic 25 bps to 11.0%; Colombia began cuts in Dec-23, shaving 100 bps off the policy rate as of Mar-24; Chile has reduced rates by 400 bps since easing began in 3Q24, and there is plenty of room to go, as today's 7.25% is quite high by historical standards[27].
- Economic Growth and Employment – With inflation easing and interest rates following, the region is well positioned for steady economic growth in 2024, which should help keep unemployment rates at or near all-time lows.
- Controlled Inflation – In addition to the boost in purchasing power that lower inflation provides across the region, in Brazil there is an added benefit: sales contracts are indexed to the INCC construction cost inflation index, and thus homes become more expensive when construction costs are increasing rapidly.

[24] Camara Chilena de la Construcción
[25] Trading Economics
[26] Camara Chilena de la Construcción
[27] Banco Central de Chile

The INCC peaked at 17.4% in 2021 and has been coming down since, reaching 9.4% at the end of 2022 and 3.4% at year-end 2023[28]; this is a big boost to affordability.

- Government Policy – the largest improvement should come from Colombia, where now that the change to government subsidies is understood, adjustments can be made – buyers in major cities like Bogota have access to different subsidies through private employee benefits organizations called Cajas de Compensacíon; buyers are now being underwritten considering such subsidies and not those of the government's Mi Casa Ya program, and thus there should be no more surprises. Additionally, to compensate for lower federal subsidies, the city of Bogota is increasing its own local programs to boost low-income housing. We believe that substantial pent-up demand exists, to be unleashed in 2024-2025. In Brazil, Lula's continued support of the *Minha Casa Minha Vida* program should continue buoying the low-income segment in Brazil. Elsewhere, in Peru and Chile the *Mi Vivienda* and *Politica Habitacional* programs are well functioning and should continue to provide subsidies and incentives aiding homeownership.
- Moderated Political Risk – other than Mexico, there are no other presidential elections in Paladin's target markets in 2024, minimizing the potential for consumer confidence to fall due to political upheaval. Even in Mexico, it is widely believed that the Morena party (candidate Claudia Sheinbaum) will easily retain the presidency, but since the party lost its super-majority in congress in 2021, its power to make drastic changes to the constitution or the direction of the economy, is limited.
- Supply – while months of inventory is elevated in most markets, we expect future supply to be largely held in check; the failure of many small and medium-sized homebuilders in Mexico and Colombia limits supply, as does the structural forces in Peru discussed above. São Paulo is the market that produces the most homes, and with a robust universe of developers, we expect supply to again be in the range of 70,000-80,000 homes. Of the city's unsold inventory, about 40,000 units (62%) are in the middle to high segments, and thus more susceptible to deterioration due to political/economic confidence, while the *Minha Casa Minha Vida* segment, representing 38% of the inventory is more susceptible to rising inflation and subsidized interest rates. Currently the market has been absorbing what is being launched, but should unexpected shocks to demand occur, depending on their nature, inventory levels could become a concern.

About Paladin Realty

Founded in 1995, Paladin Realty is a U.S. SEC Registered Investment Advisor and boutique real estate investment firm focused on value-added real estate investments in the United States and select markets in Latin America, with a focus on workforce housing. Over the past three decades, we have invested in more than 420 properties in 8 countries comprising $7 billion of total cost across a range of residential and commercial property types, with a particular emphasis on workforce housing (rental and for-sale). Our workforce housing investments to date include 90 value-added U.S. rental apartment properties totaling over 15,000 units and nearly $1 billion of cost. In addition, the firm has developed nearly 40,000 for-sale residential units across Latin America totaling about $5 billion of total cost. The firm was founded in 1995 originally in partnership with the family office of former U.S. Treasury Secretary and corporate leveraged buyout pioneer, William E. Simon. The firm's senior management team acquired 100% of Paladin Realty in 2006. See www.paladinrealty.com

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[28] Funcação Getulio Vargas