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Adios for now

The Mexican peso rallied on Joe Biden's coattails, but friendlier politics do little to fix a pandemic-ravaged economy or an overabundance of commercial real estate. In preview, we now turn from bullish to just not wanting to own former pick-to-click Fibra Uno (FUNO11 on the Mexican Stock Exchange).

The largest REIT in Mexico and, as the name implies, the first real-estate trust to list shares south of the border—that was in March 2011—Fibra Uno is not much smaller than Simon Property Group in America. As of Sept. 30, Fibra owned 10.5 million square meters of gross leasable real estate (three months earlier, Simon claimed 13.2 million), while Fibra had another 690,800 under development. Retail properties contributed 45% of third-quarter revenues, industrial 35% and office 21%.

Since we laid out the bull case in the Jan. 27, 2017 issue of *Grant's*, FUNO has generated a negative 20% return in dollar terms including reinvested dividends, driven by a 40.7% collapse in the share price. The stock did all the damage, as the Mexican peso has slightly appreciated over that 46-month span.

The retail segment of the company's portfolio has borne the brunt of viral damage, as locked-down customers shopped online and shop owners withheld rent. Through the third quarter, FUNO has offered its tenants 1 billion pesos ($50.1 million) in rent relief and charged 518.7 million pesos for accounts receivable that may or may not prove collectable. The figures sum to 1.5 billion pesos, or 0.40 pesos per share versus a current share price of 17.36 pesos.

The pandemic came at a particularly bad time for Mexican landlords. Mexico City is home to 7 million square meters of high-quality office space, and developers are busy at work on an additional 1.1 million, or 15.7% of the existing stock. With third-quarter vacancy rates at 18.6%, this large addition to supply would have been a problem, pandemic or no.

Covid-19 will only add to the time—perhaps, to be measured in years—it takes to absorb the new space, a fact that is increasingly evident in Fibra Uno's results. Thus, in the third quarter, measured year-over-year, office occupancy fell by 3.2 percentage points, to 80.6%, while new signed leases came in at a 0.9% discount to in-place rents. Rent spreads for retail and industrial were still positive.

"I'm honestly worried about offices," a local real-estate professional who asks to go nameless tells *Grant's*. "Before the virus, at least, major tenants were looking for a lot of space. Now office tenants are thinking, well, do we really need to have 5,000 square meters?" Or, can tenants make do with less space as some employees work from home? "That's going to stop demand for a while," our source concludes.

The retail supply/demand balance is only slightly better than the office sit-

Mucho debt

source: The Bloomberg

uation. According to a May report from CBRE Group, Inc., Mexico possesses 24.5 million square meters of retail space, of which 2.8 million (11.4% of the total) sat vacant. Developers are working to add 2.4 million square meters of new space to the mix.

While Fibra Uno has done a good job in terming out its debt (there are effectively no maturities in the next two years) and in maintaining a liquidity cushion, the balance sheet is now leveraged 8.7 times to trailing Ebitda, up from 5.9 times in third-quarter 2019. High leverage pairs poorly with a sizable development pipeline.

To be sure, Fibra Uno is cheap. Based on a company calculation using a 6.3% capitalization rate, net asset value per share is 42.27 pesos versus the current share price of 17.36 pesos. And notwithstanding a reduction in the quarterly dividend, to 0.317 pesos per share in the third quarter from 0.5899 per share in the fourth quarter of 2019, the plunging share price gives the stock a 7.3% yield.

But indebtedness combined with redundant capacity is a universal prescription for insomnia. We wish FUNO well—from the sidelines.

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