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White Paper on Mexico Tourism Investment Climate

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As one of the most competitive economies in the world, Mexico has long been one of the world's top tourism destinations. The country's diverse geography, history and culture, as well as rising middle class and manufacturing base, are fueling growing global and national interest in visiting Mexico as well as investing in and doing business there. Key economic and tourism-related data are testimony to this interest. The following is a summary of this data, comprising key facts and figures about the tourism investment climate of Mexico, and highlighting two tourism investment trends.

Overall, with positive growth the past few years, including record hotel occupancy and revenue, the forecast for the next few years is optimistic for visitors, residents, operators and investors. It is a good time to be in tourism and be a tourist in Mexico – and forecasted to continue evolving.

Key Country Facts:
Geographic & Cultural Diversity that help tourism demand

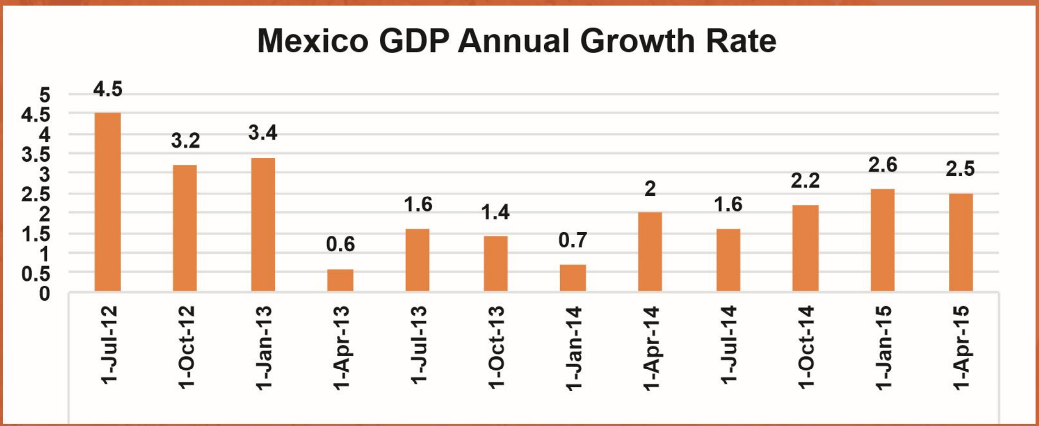
GEOGRAPHY
Everything from high mountains, low coastal plains, canyons to desert – many features of which have become key visitor attractions. At nearly 2 million square kilometers, Mexico is the 12th largest country in the world, and slightly less than three times the size of Texas. A third of the land is covered with forests, and the country is dotted with a number of semiactive volcanoes, one of which – Colima – erupted in 2010.

DEMOGRAPHICS
With a population of almost 124 million, nearly two thirds of Mexicans are Mestizo (Amerindian-Spanish), followed by Amerindians comprising about a fifth. Nearly half the population is under 24 years old with a median age of just over 27 years. Less than 14 percent of the population is 55 and older.

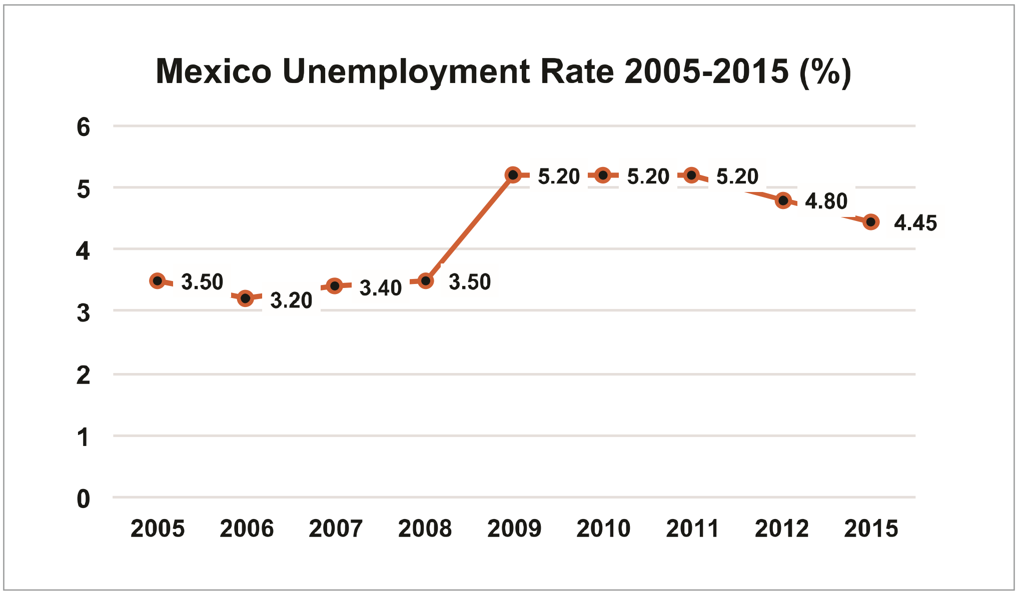
U.S. Economy & Growing Domestic Economy Driving Demand

With a gross domestic product of approximately US$1.3 trillion (2014 estimated) and per capita GDP of $10,361 (2014 estimated), Mexico is rated by the World Bank as an upper-middle-income country. The country ranks as the 12th largest economy in the world, although per capita GDP places Mexico at 93rd. About 60 percent of GDP is generated by services, of which travel and tourism are important components. Industry comprises more than 36 percent of GDP with a growing manufacturing segment, particularly automotive related manufacturing. Annual GDP growth since 2012 has ranged between 2.5 percent and 4.5 percent and is forecasted to continue at an average annual rate of 3.3 percent to 3.8 percent through 2020.

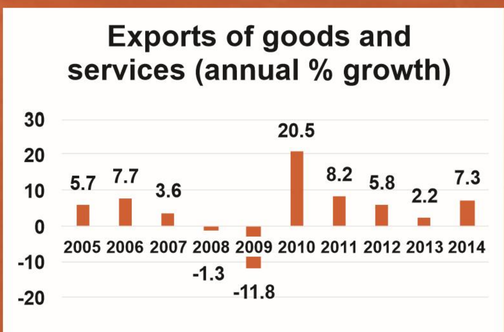
Mexico is on the move. The overall economy is growing. Unemployment is dropping. The World Bank's 2015 "Doing Business Report" ranked the country 39 out of 189, 14 places better than in 2014. Industry is steadily growing, especially exports.

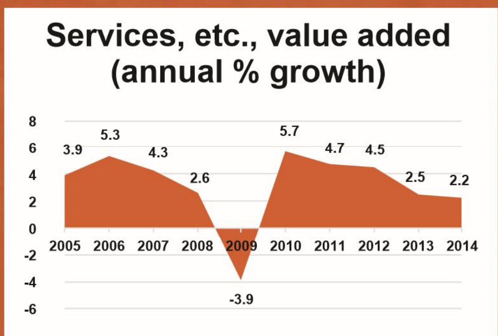


Employment trends have been similarly positive and thus have helped to drive growing demand for goods and services. As of May 2015, unemployment was at 4.45 percent, which is lower than the U.S. The unemployment rate has been hovering between 4.45 percent and 5.20 percent since 2009.



The following charts shows that services exports have been one of the brightest growth drivers, which could be attributed to international tourism growth.





Source: World Bank

The depreciation of the peso, especially against the U.S. dollar, and fluctuations in value of the euro and Canadian dollar might impact international arrivals and thus tourism spending from the European Union, Canada and the U.S., the three main sources of international arrivals in Mexico.

Figure 1: Mex pesos per 1 US$

Figure 2: Mex pesos per 1 CAD$

Figure 3: Mex pesos per 1 euro

Source: www.x-rates.com

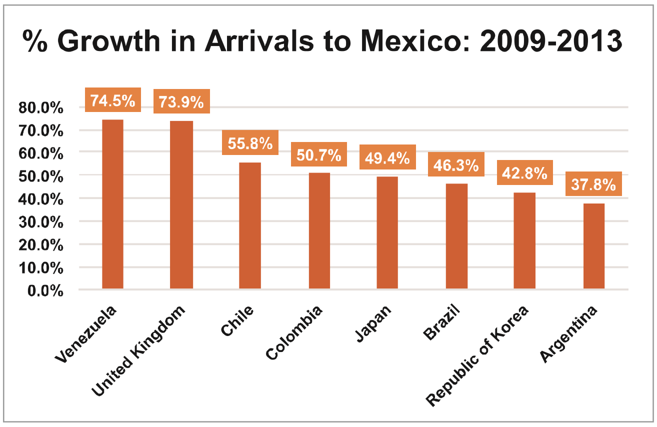
High Tourism Growth in Mexico

Tourism in Mexico is experiencing some of the highest rates of growth in the world – among the top five countries in 2014 for international tourism receipts and arrivals. **In 2014, Mexico received more than 29 million international tourists, up more than 20 percent from 2013**, thus pushing it to the 10th most visited country in 2014, a jump from its ranking as 15th the previous year. **International tourism receipts also jumped from US$13.9 billion to US$16.3 billion, a 16.6-percent increase over the same period.**

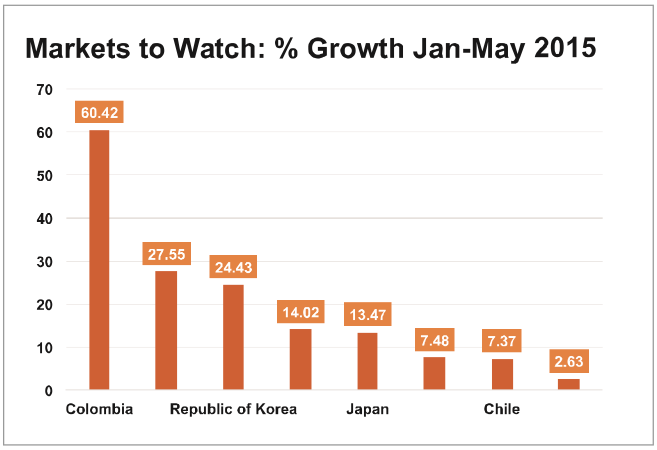
Source: SECTUR

The USA and Canada comprised nearly 85 percent of total arrivals to Mexico in 2013 and with the depreciation of the peso against the U.S. and Canadian dollars, Mexico offers good travel values. The January-May 2015 arrivals results further reaffirm this trend: Air arrivals from the U.S. were up 11.6 percent compared with the same period in 2014, and up 3.6 percent for Canada arrivals.

Several other markets, although much smaller volumes than the U.S. and Canadian markets, were also showing substantial growth in arrivals to Mexico:

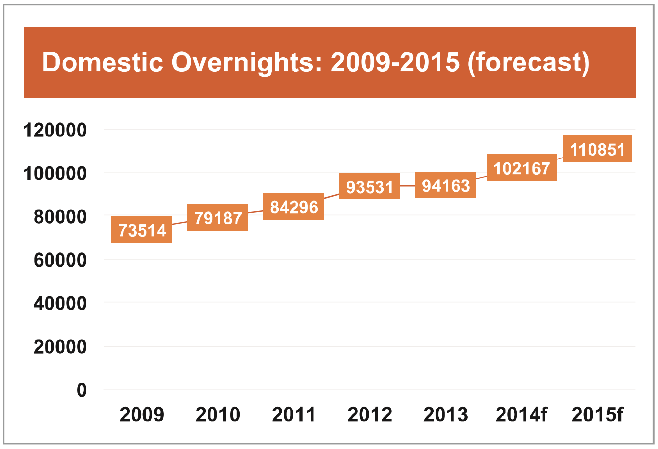


Source: SECTUR, UNWTO



Source: UNWTO

Domestic tourism also has been a rapidly accelerating source of tourism growth for the country. The latest data from the Secretaria de Turismo shows steady increases since 2009. According to the firm Research and Markets, domestic tourism has been increasing at a compound annual growth rate of 8.5 percent since 2010. The World Travel & Tourism Council estimated in its 2015 Mexico Report that domestic travel spending generated 88.8 percent of direct travel and tourism GDP in 2014. WTTC expects domestic spending to continue growing at 4.1 percent per annum to US$205 billion by 2025.



Source: SECTUR, UNWTO

Mexico's Ministry of Tourism aims for the country to be a world leader in tourism. Given the above statistics and its leap forward on the World Economic Forum's Tourism Competitiveness Index from 44th in 2013 to 30th in 2015, the country is well on its way. By 2025, the WTTC forecasts that Mexico will be receiving 39.2 million international tourists.

The WTTC's 2015 Mexico Report also points to tourism having directly supported 3.7 million jobs (7.4 percent of total employment) and with jobs indirectly supported also included, the total is more than double – 7.8 million jobs, or 15.7 percent of all total employment. By 2025, the WTTC forecasts that this will increase to 10.2 million jobs, or 17.2 percent of total employment. In 2014, according to WTTC, travel and tourism attracted US$8 billion in capital investment and is expected to rise an estimated 6.5 percent per annum to US$16 billion by 2025.

Leisure travel generates approximately 90 percent of tourism GDP (US$132 billion) with the remaining 10 percent generated by business travel. Leisure travel is forecasted to continue growing 4.3 percent per annum to 2025 and business travel by 6.5 percent, which bodes well for the Mexican economy overall as well as tourism and lodging growth.

Supporting this spending is **extensive and growing transportation infrastructure,** especially the air transport infrastructure, which the World Economic Forum's 2015 Travel & Tourism Competitiveness Index ranked at 42 out of 141. Road and port infrastructure do not fare as well on the Index with a ranking of 72 out of 141. Mexico counts 1,714 domestic and international airports (the third highest number in the world) that serviced 65 million international and domestic passengers in 2014, an increase of 8.5 percent over 2013. Twenty-seven of the top 30 airports in Mexico all experienced increases in passengers over 2013 ranging from 2 percent (Mexicali) to 23 percent (Leon). (Source: Secretary of Transportation: http://www.sct.gob.mx/fileadmin/DireccionesGrales/DGAC/04 percent20Estadisticas percent202012/01 percent20Aviacion percent20Mexicana/AMC_2014.pdf).

Ground transportation infrastructure is also substantial with 377,660 kilometers of roads (approximately a third of which are paved) and 17,166 kilometers of rail lines (16th in the world). The lower rating on the WEF TTCI underscores the need for increased public and private investment to improve and expand ground transportation infrastructure.

The government coordinates tourism-related infrastructure through the Tourism Cabinet with inputs from the Ministry of Tourism, the Ministry of Transportation and Communications and the Ministry of Finance. To help accelerate tourism growth, the government established the National Infrastructure Program (2014-2018), which includes the tourism sector as a strategic sector for the first time. An investment of US$13.9 million has been allocated for 83 tourism-related infrastructure projects.

In addition, the country's National Trust Fund for Tourism Development (FONATUR), which plays a critical role in tourism investment and development in Mexico, also plays an important role in the development of tourism infrastructure, especially in and around the major integrated resort developments.

Mexico also has several ports, including the cruise ports of Cancun, Cozumel and Ensenada, which received a record 3.8 million passengers in 2014, up 24 percent over 2013. Passenger spending, however, was down by 16 percent, a challenge that needs to be addressed.

With the optimistic forecasts for international travel to and domestic travel in Mexico mentioned above, the tourism industry is generally thriving and seems positioned to continue thriving for the next several years. In 2014, according to SECTUR data, the most visited destinations overall are indicated below.

Beach Resort Destinations	Total Visitors 2014	Variation 2013/14
Cancún	6,020,823	36.3 percent
Acapulco	4,590,910	-0.9 percent
Riviera Maya	3,712,818	3.4 percent
Veracruz	2,665,880	8.4 percent
Mazatlán	1,921,951	10.2 percent
Puerto Vallarta	1,675,516	3.4 percent
Los Cabos	1,331,223	-6.4 percent
Nuevo Vallarta	1,163,059	3.7 percent
Ixtapa Zihuatanejo	599,057	11.3 percent
Cozumel	585,086	30.7 percent
Manzanillo	506,012	-0.1 percent
Playas de Rosarito	445,802	2.7 percent
Bahías de Huatulco	402,733	3.4 percent
Puerto Escondido	332,061	22.7 percent
Isla Mujeres	300,362	11.9 percent
La Paz	289,487	-3.3 percent
Tonalá-Puerto Arista	134,028	18.1 percent
San Felipe	108,092	5.6 percent
Loreto	87,181	-3.3 percent

Source: SECTUR

For beach, thus leisure, destinations, the great leaps forward in growth for certain destinations is worth highlighting, especially for tourism and hotel investments: Cancun (36.3 percent), Cozumel (30.7 percent), Puerto Escondido (22.7 percent), and the domestic destination of Tonalá-Puerto Arista (18.1 percent).

It is worth noting the differences in popularity between national and international visitors. For example, Acapulco is the No. 1 beach destination for Mexicans, but No. 8 for international visitors. Cancun, which tops the list for international visitors, is getting more popular with Mexicans, more than a 26 percent increase over 2013. The differences are worth keeping in mind for tourism, and especially lodging investors interested in these destinations:

	National Visitors 2014 I Variation 2013/2014			International Visitors 2014 I Variation 2013/2014	
Acapulco	4481115	-0.43 percent	Cancún	4002460	42.13 percent
Veracruz	2623706	8.77 percent	Riviera Maya	3607175	3.33 percent
Cancún	2018363	26.08 percent	Los Cabos	985189	-8.46 percent
Mazatlán	1604972	13.42 percent	Puerto Vallarta	478848	21.35 percent
Puerto Vallarta	1196668	-2.39 percent	Nuevo Vallarta	433750	24.68 percent
Nuevo Vallarta	729309	-5.78 percent	Cozumel	349166	33.11 percent
Ixtapa Zihuatanejo	507086	8.38 percent	Mazatlán	316979	-3.51 percent
Manzanillo	476564	-1.48 percent	Acapulco	109795	-17.95 percent
Bahías de Huatulco	360645	4.06 percent	Isla Mujeres	106186	-22.53 percent
Los Cabos	346034	0.22 percent	Playas de Rosarito	100650	4.62 percent
Playas de Rosarito	345152	2.11 percent	Ixtapa Zihuatanejo	91971	30.25 percent
Puerto Escondido	326624	22.91 percent	Veracruz	42174	-8.89 percent
La Paz	259974	-4.76 percent	Bahías de Huatulco	42088	-1.61 percent
Cozumel	235920	27.23 percent	San Felipe	35599	2.29 percent
Isla Mujeres	194176	47.90 percent	La Paz	29513	11.87 percent
Tonalá-Puerto Arista	134027	18.11 percent	Manzanillo	29448	30.56 percent
Riviera Maya	105643	7.53 percent	Loreto	24051	-4.62 percent
San Felipe	72493	7.26 percent	Puerto Escondido	5437	8.85 percent
Loreto	63130	-2.84 percent	Tonalá-Puerto Arista	1	NA

Source: SECTUR

Beyond the beaches, the major cities – Mexico City, Guadalajara and Monterrey – attract millions of visitors, again with important differences between national and international visitors. They attract far fewer international than national visitors.

	National Visitors 2014		International Visitors 2014	
Mexico City	9,006,292	3.9 percent	2,013,481	17.6 percent
Guadalajara	2,826,391	1.4 percent	361,697	13.0 percent
Monterrey	1,434,656	3.7 percent	364,439	19.6 percent

Source: SECTUR

Other interior cities in Mexico also attract varying numbers of national and international visitors and thus rank differently in terms of popularity.

- The top five other interior cities for national visitors are: Puebla, León, Mérida, Querétaro and Oaxaca. At the top of the list for 2014 is Puebla, which attracted 1.8 million visitors followed by León, which attracted 1.3 million.
- The top five other interior cities for international visitors are: Puebla, Tijuana, Mérida, Oaxaca and Campeche. Note: Same-day visitors are not included in these counts. Puebla also tops the list, but with far fewer international than national visitors, only 279,168 followed by Tijuana at 263,954.

Lodging Sector Growth Parallels Tourism Trends

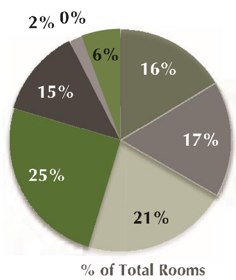
At the 5th Annual Mexico Hotel & Tourism Investment Conference in Mexico City in March, Richard Katzman, the HVS Managing Director for Mexico City, was optimistic about the future of the lodging sector in Mexico. In his presentation and subsequent summary ("Four Key Takeaways," co-authored with Astrid McDowell), he said that "[a]n overall optimistic outlook remains in terms of both the corporate/business and leisure/resort lodging sectors." Katzman explained that although security concerns generate negative press coverage and are real concerns in certain mostly nontouristic parts of the country, Mexico's economy is generally strong, growing and thus generating more demand, particularly for business travel. Katzman emphasized that the growth does vary from region to region with business travel driven especially by key industries such as automotive, aeronautical and energy. Central Mexico, in particular, is benefiting from the heavy presence of automotive manufacturers and airplane parts suppliers. He urges caution, though, in rolling out hotel investments in business travel-oriented destinations.

HVS reported that while the urban Mexico markets realized revenue-per-available-room growth of 9.1 percent, the resort markets achieved 19.7 percent growth in 2014. The company explained that "the leisure/resort lodging segment is expanding in two primary regions: along the Cancun-Riviera Maya corridor of the Yucatan Peninsula and in different Pacific coastline destinations, such as Los Cabos, Puerto Vallarta, Huatulco, and the Costa Alegre region." This trend is in line approximately with the arrivals figures mentioned above.

With 90 percent of tourist demand concentrated on leisure travel, it is not surprising that the Yucatan Peninsula region realized the highest occupancy, ADR and RevPAR growth in Mexico – and as mentioned above, growth in national and international tourism arrivals.

Overall, Mexican and U.S. hotel chains are trying to expand their footprints throughout Mexico. Lodging Econometrics reported 147 projects with 21,942 guestrooms in the pipeline as of the first quarter of 2015, representing increases of 7 percent and 9 percent, respectively, over Q1 2014. As the following chart shows, most of the projects are concentrated in the upper midscale and upscale categories.

LE's Construction Pipeline by Chain Scale



	Projs	Rms
Luxury	18	3,587
Upper Upscale	9	3,721
Upscale	34	4,692
Upper Midscale	45	5,472
Midscale	29	2,813
Economy	4	399
Casino	0	0
Unbranded	8	1,258
Total Pipeline	**147**	**21,942**

Source: LodgingEconometrics.com

Given the following positive hotel results for 2014, as reported by STR, it is not surprising that the pipeline is growing and the international brands are showing increased interest.

Mexico: Key statistics

~25% report to STR

		% Change
• Hotels	3.4 k	
• Room Supply	126.7 mn	1.2%
• Room Demand	79.1 mn	6.4%
• Occupancy	62.4%	5.1%
• ADR	₱1604.35	1.5%
• RevPAR	₱1001.42	6.7%
• Room Revenue	₱126.9 bn	7.9%

STR Year end 2014

Two Key Trends Impacting Hotel Investment

As HVS emphasized, increased hotel investment interest is being impacted by two key trends:

1. Increased availability of financing through Mexico-based real estate investment funds and trusts – FIBRAS and CKDs.
2. A shift away from European Plan-based offers toward all-inclusive resorts.

A change in law has allowed the formation of real estate investment trusts called FIBRAs. These allow Mexican institutional investors to take positions in real estate and pool their capital for multiple investments with specified exit strategies. FIBRA 1 was established in 2011 as a general REIT and now has a US$10 billion market capitalization, thus placing it among the top five REITs globally. Mexican income tax law requires that a FIBRA annually distribute at least 95 percent of its net taxable income.

Two FIBRAs specialized in hotel investments have also been formed. One known as FIBRA Hotel has invested in 20 Marriott hotels. The fund's assets are mostly managed by Grupo Posada. The second fund, FIBRA Inn, started with positions in 14 hotels, several of which are Holiday Inn Express-branded hotels, as well as Wyndham Garden, Aloft, Hampton Inn and Microtel by Wyndham, among others.

In March 2015, HotelNewsNow.com reported that FIBRA Inn was seeking to bring more U.S.-based hotel brands to Mexico. They are aiming to invest US$160 million in 15 hotels each year over the next two years. According to Joel Zorilla, vice president of corporate strategy for FIBRA Inn, "Those hotels will have a strong focus on the business segment, as the company's current portfolio caters to the business traveler. Fibra Inn is targeting brands such as Hampton Inn, Aloft, Holiday Inn Express and Wyndham."

As of July 2015, FIBRA Inn reported 22-percent growth in RevPAR for June 2015, which they stated was the result of a 3.8-percent increase in occupancy and a 14.3-percent increase in average daily rate.

The other investment vehicle that is gaining traction for hotel investments are known as Certificados de Capital de Desarrollo (structured equity securities or CKDs), which are private-equity funds, mostly related to infrastructure development. Created in 2009, CKDs are intended to allow additional capital to flow into private companies, infrastructure and real estate projects in Mexico.

Through the regulatory changes that helped create the FIBRAS and CKDs, the government is pushing to make Mexico more attractive to investors.

The second key trend is an increased trend among resort properties to move from European Plan, or lodging only plan, to an all-inclusive one. This trend mirrors a global increase in customer preference for an all-inclusive product. Kristina M. D'Amico, senior analyst with HVS Miami, aptly summarized this growing trend in a May 2015 HVS article. "Additional guest spending (i.e. 'non-package' revenue) is higher than in the traditional model because guests have actually prepaid for their trip and feel 'compelled' to spend some money while on vacation… consumers are more and more willing to splurge outside the initial vacation package purchase, " she wrote. Related to this is the increasing tendency for tour operators to work with all-inclusive resorts to offer a variety of excursions, thus maximizing time outside the resort and increasing the resort's bottom-line revenue.

In Mexico, Hyatt and other international brands are increasingly offering all-inclusive resorts. Currently, 80 percent of the properties in Cancun are operating as all-inclusive properties. In total, according to HVS and the Mexico Tourism Board, Mexico has 78,204 all-inclusive rooms (as of May 2015). This trend seems likely to continue.

Regulatory Environment

President Enrique Peña Nieto created and chairs the Federal Tourism Cabinet, which includes ministers and sectoral stakeholders, in order to factor public and private sector stakeholder interests in the implementation of the new national tourism policy. The policy focuses on four key principles, all of which bode well for tourism investment overall and, in particular, hotel investments:

1. **Planning and sectoral transformation:** The Federal Tourism Cabinet will coordinate tourism-related budgets and planning across all levels of government.
2. Innovation and competitiveness: The policy includes a focus on product diversification and improved destinations.
3. **Development and promotion:** The government assumes responsibility for planning, developing and promoting destinations, and facilitating private-sector efforts.
4. **Sustainability and social benefit:** The government will work with all of society in creating tools to help Mexico's tourism industry preserve natural resources, heritage, history and culture. The tools include: an Environmental Quality Tourism certification system and a Clean Tourism Destination initiative that encourages municipalities to ensure that high standards of water and solid-waste management are integrated into the tourism services offered in the destination.

Programs based on these principles will help the country address some of the following challenges highlighted by the World Economic Forum's Travel & Tourism Competitiveness Index. If these issues are not addressed, the country's tourism competitiveness and attractiveness as a tourism investment destination longer term could be diminished:

WORLD ECONOMIC FORUM

The Travel & Tourism Competitiveness Report 2015

Costs related to construction permits – 131/141
Market competition – 114/141
Taxation levels – 116/141
Profit tax rate – 117/141
Safety and security – 124/141
Environmental sustainability – 126/141
Threatened species – 137/141
Business environment – 126/141
Visa requirements – 102/141

Concluding Thoughts

Despite relatively slow GDP growth and several challenges to the country's tourism competitiveness, the tourism industry has continued to grow. An expanding consumer base in Mexico combined with increased investor interest, thanks in part to FIBRAS and CKDs, are helping to boost tourism demand and available offers. Combined with industrial growth in some regions, this demand has been translating into hotel demand, which is fueling record levels of occupancy levels, RevPAR and ADRs. The country's focused efforts through the Federal Tourism Cabinet and new National Tourism Policy are also helping to boost relatively fast-growing domestic demand, as well as international demand among existing and emerging markets. The government is intent on transforming Mexico into a global tourism leader. If the policy can be fully implemented and the above issues, particularly those that could further strengthen the investment climate, can be tackled, the country will fully benefit from the broad socioeconomic, cultural and environmental benefits that a sustainable tourism sector offers.

About the Author:

Scott Wayne is the President of SW Associates (www.sw-associates.net), a Washington, DC-based tourism development and strategy consultancy. He is a frequent strategic advisor to companies, investors, destinations and the World Bank Group/IFC in over 45 countries.

HVS (www.hvs.com) and Lodging Econometrics (www.lodgingeconometrics.com) provided invaluable input to the White Papers. HVS is a world leader in hotel consulting, valuation, management and multiple other areas of industry expertise. Lodging Econometrics is a preeminent industry consulting partner for global real estate intelligence and analysis of trends.

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