

Trends and Developments

Contributed by:

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Ritch Mueller

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ancial, industrial, infrastructure, energy, retail and services sectors, among others. Its staff of more than 100 professionals seek to add value to clients by means of an efficient and in-depth service combined with high levels of expertise and experience.

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Javier Domínguez joined Ritch Mueller in 1995 and was named partner in 2007. He has more than 28 years of experience, focusing on real estate transactions and financing,

capital and debt offerings in Mexico and abroad, secured and unsecured financing, financing to states and municipalities, and M&A. Javier has advised the world's largest industrial facility developer, providing advisory on acquisitions, dispositions, developments, leasing and financings. He has also advised real estate investment funds and other investors in respect to their investments and developments in Mexico, including property acquisition, disposal, financing, development and management of assets.



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Gabriel Torres joined Ritch Mueller in 2013 and was named partner in 2023. He has more than 17 years of experience in structuring and implementing real estate projects, with an emphasis on portfolio acquisitions, joint venture agreements, development and construction, hospitality, and formation of private equity funds. Furthermore, he advises domestic and foreign financial institutions in breach and long-term financings, as well as in structuring collateral packages largely over real estate assets. Gabriel is also active in M&A in a wide variety of sectors.



Diego Rodríguez joined Ritch Mueller in 2021. He has experience advising buyers, private equity funds and sellers in the acquisition process of companies, in both domestic and international transactions. In addition, Diego has advised clients in real estate projects, as well as in the acquisition and sale of real estate portfolios. In the financial sector, he has represented borrowers and lenders in structuring and implementing financings, with particular consideration of the environmental, social and governance components of investment.

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Mexico: Are We Moving Towards the Nearshoring Paradise?

Background

Due to its privileged economic and geographic position, Mexico is playing a leading role in nearshoring, which has become a popular topic in the international business scene. Is nearshoring already a reality? Will the country succeed in capitalising on the promises of nearshoring? What are the main challenges to achieve this? What do investors seek?

Nearshoring is a strategy used by companies to relocate production chains, processes and services, among others, to areas geographically adjacent to the main consumer markets in order to reduce costs. For example, a nearshoring strategy for a European company with its main customers in the United States would consist of establishing its production processes in a place such as northern Mexico, in order to reduce the cost of transporting its products to its main customers.

In recent years, offshoring, which is the strategy that contrasts with nearshoring, has shown some limitations that have led companies to seek alternatives to reduce costs. For example, US or European companies choosing to establish their production chains in Asian countries face cultural and linguistic differences that can increase production costs, as well as logistical and geopolitical challenges. These constraints and challenges have been manifest in recent years with events such as the COVID-19 pandemic, the Russia–Ukraine war and the US–China trade war.

For example, the global COVID-19 pandemic caused massive disruptions in global supply chains due to closing of borders and trade blockades. These supply chain constraints were

greatest in South-East Asia and East Asia, the regions with the highest concentration of offshoring.

The Russian invasion of Ukraine, which began in February 2022 with the military aggression ordered by President Vladimir Putin in regions along their countries' shared border, resulted in an increase of gas and oil prices, which in turn increased the cost of transporting goods. These changes in supply chains have led to global imbalances causing certain companies to consider nearshoring strategies in order to reduce geopolitical risks.

In addition to the COVID-19 pandemic and the Russia–Ukraine war, the US and China industrial trade war, which began in 2018 during Donald Trump's presidency, and continues today, has caused a significant increase in import tariffs on certain products in both China and the US.

Altogether, while offshoring initially offered cost savings advantages in terms of labour and supply chain expenses, the drawbacks outlined above have prompted companies to reassess their over-reliance on specific global regions. In this context, nearshoring has become an attractive alternative for companies, due to this strategy's relatively low production costs, compared to those of the companies' country of origin, and geographic proximity reduces relocation and logistics costs.

Nearshoring opportunities in Mexico

Mexico has positioned itself as one of the main destinations among the countries offering nearshoring opportunities. This is due to, among other factors:

- the border with the United States, one of the largest consumer markets, along with the

similarity between the time zones of both countries;

- the trade agreements that Mexico and the United States have entered into, such as the USMCA, which provide certainty to producers and reduce export costs;
- the relatively low human capital costs and the high level of specialisation as a result of already established manufacturing industries, such as the automobile industry and the software industries;
- the similarity between Mexican and US cultures, especially along the border; and
- competitive production process supply costs.

[An analysis by the Inter-American Development Bank \(IDB\)](#) recognises Mexico's advantageous position. The IDB estimates that nearshoring will increase global exports from Latin America by USD78 billion in the short and medium term, of which 45% would be from Mexico.

These and other factors have led to greater foreign investment in Mexico, led by companies seeking to benefit from nearshoring by establishing their production processes in Mexican industrial parks. For instance, at the beginning of 2023, the Ministry of the Economy reported that in 2022 the foreign direct investment in Mexico increased by 12% compared to 2021 and 48% of all foreign direct investment received was from new investors. This percentage of new investors is the highest the country has seen in the last ten years. The data shows that foreign companies that had not previously invested in Mexico want to set up operations in the country. This follows the reasoning behind nearshoring, which is to establish production chains near the target markets: in the case of Mexico, the United States market.

In the private sector, BBVA Research, along with the Asociación Mexicana de Parques Industriales Privados, A.C. (AMPIP), conducted a survey to quantify and anticipate the effects of nearshoring in Mexico. From that research, BBVA Research and AMPIP concluded, among others, that since the beginning of the US–China trade war in 2018, private industrial parks in Mexico have received approximately 830 new foreign tenants, 20% of which come from Asian countries. On par with new tenants, AMPIP concluded that already established tenants also want to take advantage of the nearshoring boom, as they noted that from 2018 to 2022, 21% of the already established companies expanded their leased spaces in industrial parks.

Regarding the increase in demand from Asian countries for profitable spaces to establish production chains in Mexico, in late 2023 AMPIP officials reported that just over 40% of the mentioned increase in demand during 2022 and 2023 came from Chinese companies. Overall, AMPIP reported that the total number of private industrial park tenants increased by 52% from 2019 to 2022. As AMPIP points out, many of the companies opting for nearshoring strategies are looking to establish in new industrial parks. To meet the demand for new parks, several market players have mentioned that new industrial projects are already under development. AMPIP, for example, reports that there are already 50 new industrial projects to be built between 2023 and 2024. Fibra Mty, one of the main investors in industrial portfolios in northern Mexico, estimates that it will, in the short term, expand the total area of its portfolio by nearly 52,000 square metres to have sufficient space for tenants that seek to implement nearshoring strategies.

Attracting foreign investment

In this scenario, local governments and the federal government have sought to design strategies to attract as much foreign investment as possible, although in most cases there has been no effective co-ordination, resulting in delays and increased time and costs for investors and developers.

The federal government's main strategy has been to grant tax incentives, in order to encourage foreign capital investment. Specifically, on 11 October 2023 the President issued a decree granting tax incentives to certain sectors. These incentives consist of (i) an immediate deduction for investments in new fixed assets used for export activities, and (ii) a deduction for additional personnel training expenses. The first tax incentive benefits ten industries, including food, medical-pharmaceutical, electronic components (computers, software) and automotive, and is granted to companies involved in the production, processing or industrial manufacture of goods that are intended for export. The second tax incentive is subject to certain limitations.

This strategy has been criticised by organisations with expertise in public policy. For instance, according to the Public Policy Research Center of the Mexican Institute for Competitiveness (*Centro de Investigación en Política Pública del Instituto Mexicano para la Competitividad*, IMCO), the tax burden is not one of the main concerns of companies seeking to relocate their production chains to Mexico. Although tax costs are an important issue to consider when deciding to invest in Mexico, IMCO states that the main concern of investors is the availability of modern industrial space with a sufficient supply of all necessary production supplies.

Analysts from financial institutions such as Intercam Banco and Banco BASE concur with IMCO's analysis. In several interviews, experts from these institutions stated that for Mexico to benefit from nearshoring, the government must increase public investment to develop infrastructure for public services such as water, electricity, and education, to create adequate conditions to attract foreign investors. In order to secure investment, the country must increase the supply of available space and services at the same rate as the increasing demand.

Infrastructure and other challenges

As discussed above, in order to capitalise on the unique opportunity offered by nearshoring, both the Mexican government and the private sector must focus their efforts on addressing the deficiencies that potential investors identify as obstacles to locating their production chains in Mexico. As part of the survey mentioned above, BBVA Research and AMPIP asked industrial parks what they considered to be the main obstacles that could limit foreign investment. Of the parks surveyed, 91% reported problems with the supply of electricity, and 63% reported problems with water availability.

Fitch Ratings' analysis is in line with AMPIP's finding that the main hurdle Mexico is facing concerning the nearshoring boom is the lack of access to electricity. Changes in legislation and public policy related to the electricity market over the current presidential term have limited the growth of the industry by restricting the entry of private capital.

With regard to water, officials from the National Water Commission (*Comisión Nacional del Agua*) have stated that the imbalance in the distribution of rainfall, combined with the lack of hydraulic plans at the state level that are prop-

erly integrated at the federal level, have led to water shortages in different regions of the country. Shortages have occurred especially in the northern region, which is the area of greatest interest to new investors due to its proximity to the United States.

In addition, developers and investors face other issues that may affect the growth of nearshoring, which have been raised in conferences organised by the GRI Club. First, there is a difficulty in accessing “green” or sustainable nearshoring in which the new industrial parks comply with the ESG requirements of foreign investors and of the different financing sources. Specifically, in addition to various certifications in the construction and development of industrial parks, such as LEED and EDGE, that investors and financing sources require, they are requiring that the energy sources of these nearshoring projects are renewable. Given the federal government’s energy policies, this objective has become extremely difficult to meet.

The other issue that developers and investors in the GRI Club conferences have identified as a barrier to nearshoring is the lack of clarity about local, state and federal processes and costs associated with obtaining permits and licences required to develop infrastructure and the industrial parks. Regulatory and bureaucratic barriers related to certain permits and licences in some municipalities and states (and especially at the federal level) create great uncertainty about the time required to obtain such permits and licences. Regarding the costs associated with the necessary infrastructure, the lack of support and compliance from the authorities at the three levels of government, as well as (ever-increasing) requirements, increase the cost of projects in ways that are often unexpected and cannot be budgeted for in advance.

UBS bank officials have pointed out that the development of industrial infrastructure is one of the main indicators that determine the effect of nearshoring during this first phase. Considering what has been discussed in the previous paragraphs, it seems that the lack of infrastructure is one of the main obstacles identified by key market players. In this regard, UBS officials agreed that Mexico has not seen a significant increase in the development of industrial infrastructure.

The Tesla example

The Tesla case is an example of the challenges that Mexico has in welcoming investors who want to set up their production processes in the country. In February 2023, the federal government announced the investment of the automotive company Tesla in the state of Nuevo León to set up a “gigafactory” of electric vehicles. The announcement was accompanied by questions and criticism about the viability of the project. Regarding water availability, several Nuevo León government officials have stated that nearby wells in the area where the factory will be built lack sufficient reserves to supply the residents of adjacent neighbourhoods.

Regarding electricity supply, the government of Nuevo León revealed last October that the local government has made a commitment to build infrastructure to facilitate access to electricity for the factory, as part of the preliminary agreements for Tesla to complete its project in the state. The problems of water and electricity shortages stem from a lack of infrastructure, since in order to supply the gigafactory, the US company requires pipelines to channel water, power plants to produce electricity and transmission lines to transport it.

The example of Tesla illustrates some of the country’s limitations, and shows that govern-

ments must commit to developing infrastructure and making services available in order to achieve a large-scale project such as the gigafactory. At the same time, this example offers some hope, as it shows that it is possible to earn the benefits of nearshoring when the will of investors is aligned with that of governments.

Conclusion

In the current context of the nearshoring boom, Mexico holds an advantageous position that sets it apart from other countries competing to attract foreign production chains, particularly those companies whose main customers are located in the United States. Based on the aforementioned data, nearshoring has increased investment in Mexico, particularly with a growing number of new investors. This reality means that there is an increased demand for modern industrial spaces and services, such as water and electricity, which the country may not be prepared to meet.

Both the private and public sectors have developed strategies to fully utilise the benefits of nearshoring. Nonetheless, Mexican investors can still seize certain opportunities to accelerate the development of the country's industrial zones and benefit from the historic opportunity that nearshoring represents.