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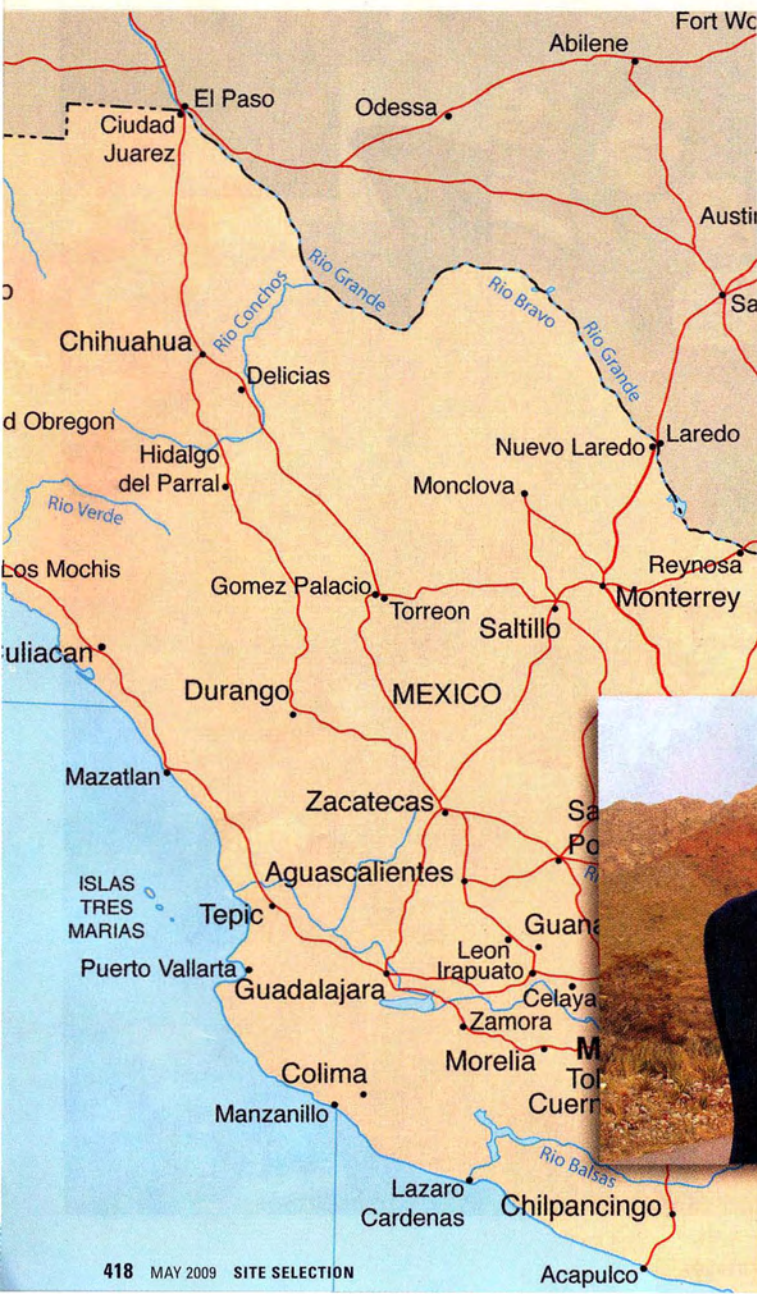
Early Signs of Recovery Seen Along The U.S. - Mexico Borderzone

by MICHAEL G. WHITE,
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Given the deep base of manufacturing facilities located along the U.S.-Mexico Borderzone, we believe the first signs of a broad economic recovery will be seen in this region, as companies ramp up production and utilize excess capacity that they have been holding in reserve. Sophisticated manufacturers have for years been operating in a lean environment and producing lower inventories, just-in-time for their end customers. Like most companies, these manufacturing plants have pared their overhead and staffing through layoffs and four-day workweeks to cut operating costs. Despite these cost reductions, clear direction from their corporate headquarters has been consistent: Do not reduce capacity.

Unlike previous cyclical downturns, companies have not shuttered plants or turned keys back to their landlords. Most manufacturers in the Borderzone expect to ramp up quickly at the first signs of recovery, in hopes of grabbing early market share. While we are cautious against pinning hopes on a "false dawn," there are early signs that manufacturing is now ramping up along the Borderzone. A robust revival is expected in late 2009 as store inventories burn off, housing continues to stabilize and stimulus money is spent

Mike White, senior partner at TeamNAFTA, recently traveled to the Texas-Mexico border region around Juarez and offered a telling firsthand account. Among his observations: "the drug violence ... is clearly receding."



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on a myriad of projects.

The Borderzone's technically skilled work force represents an important component to America's global competitiveness. Lower labor costs coupled with geographic proximity permit American manufacturers to keep major assemblies within the U.S. and source sub-assemblies from just over the border. There is a clear shift under way of relocating manufacturing from China and returning back to North America. In manufacturing parlance, this phenomenon is known as shifting from "off-shore" to "near-shore."

In most cases where labor content represents 40 percent of the total cost of the finished product, manufacturers are choosing to locate on the Mexican side of the Borderzone for low margin, labor-intensive products. This shift from China is driven by an increasing strain on the Chinese cost model, most notably: labor, fuel, piracy, bureaucracy and the management of a distant supply chain. Mexico's Borderzone will clearly be the beneficiary of this shift to near-shore manufacturing. As an added incentive, the Mexican peso has devalued against the US dollar by almost 20 percent over the past six months, making Mexican labor even more competitive relative to that found in China.

The drug violence that scourged many Mexican cities along the Borderzone is clearly receding. The Mexican government is bolstered by their success in beefing up law and order in these communities through combining police and military patrols. Over 95 percent of the widely reported drug violence involved members of the various cartels, and there was little threat to the day-to-day operations of the plant management; however, the Borderzone citizens have lived courageously through their fear. I just spent a week in Juarez in April, traveling freely and safely throughout all parts of the city. I moved easily from plant to plant, visiting clients and giving site tours. There were shoppers in the stores, the restaurants were busy and the kids were back out at the skate parks.

The Borderzone has diversified its manufacturing base and is no longer completely reliant upon the automotive industry. Most of the flat panel televisions sold in North America are assembled and shipped from the Borderzone. Firms such as Foxconn, Inventec and Flextronics, all of which have expanded their capacities in dramatic scale, produce an increasing

percentage of computers and servers. The automotive industry will continue to be an important Borderzone player and certainly contribute to supplier growth as the industry readjusts to America's new frugality. Responding to new

consumer sentiment that appears averse to excessive debt, the North American auto market is settling into a new median purchasing volume that the industry will adapt to. Fewer cars will be produced and much of their production cost will be shifted away from high wage regions to near-shore Mexico sites like Juarez.

Global trade as measured by port-served communities is down between 20 percent and 40 percent year-to-year, but third party logistics ("3PL") business inside the U.S. is clearly on the increase. How can this apparent contradiction be explained? The central theme across corporate boards is to cut costs. 3PLs offer flexibility and shorter terms for manufacturers who are managing complicated inventories. 3PLs now join staple industries like food-related processing and medical

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products in their resilience to the current economic downturn. 3PL presence along the Borderzone is growing exponentially as the industry diversifies and near-shoring increases.

The Borderzone plants represent a springboard for any economic recovery, as these factories will ramp up production in advance of increasing orders for their products. The continuing relocation from China to Mexico bears witness to the importance of the Borderzone's role in the overall American economy. With several thousand plants shipping northbound residential water heaters, automotive seats, computers, electronics and just about everything America needs, we will be able to detect a sustainable rally. Watch this Borderzone region closely for early signs that a recovery in manufacturing is finally underway.

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