S&P Global Ratings

Environmental, Social, And Governance Evaluation

Fibra Terrafina

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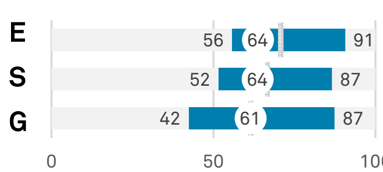
Summary

Fibra Terrafina (Terrafina) is a real estate investment trust (REIT) that primarily acquires, develops, leases, and manages industrial real estate properties in Mexico. Terrafina's portfolio mostly consists of light manufacturing properties and warehouses throughout the central, Bajio and northern regions of Mexico. About 70% of tenants are U.S.-based multinational companies that focus on manufacturing for export activities, while the remaining tenants operate in other segments such as logistics. Tenants are well diversified across the company's 273 real estate properties totalling gross leasable area (GLA) of 38.6 million square feet and five land reserve parcels. Development activities represent a small share of Terrafina's business; similar to most peers in the sector.

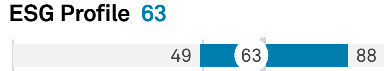
Terrafina's ESG Evaluation of 65 reflects the company's adequate preparedness, which is based on its highly experienced board and a strategy that's increasingly emphasizing sustainability. But its overarching approach to ESG and innovation has a short track record and depends on effective partnerships with the company's key counterparties. The ESG profile incorporates the company's heightened exposure to environmental and social risks given the environmentally intensive nature of its industrial property portfolio and challenges associated with Mexico's environmental and social practices. Terrafina's approach to environmental management is focused on better data collection, and it has set some key targets to improve performance, including for GHG emissions, which is common among peers. But high water stress and weaknesses in Mexico's waste management system remain substantial obstacles. The company's social profile benefits from stable relationships with its multinational tenants, but Terrafina has limited oversight over workforce and safety risks across its value chain, where these risks can materialize. Terrafina's governance includes a board with extensive experience and high number of independent members, although with a joint-CEO chairman role, along with additional governance practices that exceed local requirements.

ESG Profile Components (figures subject to rounding)

Entity-specific assessment			Sector/region analysis			Achieved and attainable scores
E (30%)	23	+	E (30%)	41	=	E
S (30%)	27	+	S (30%)	37	=	S
G (40%)	39	+	G (40%)	22	=	G
Entity within its primary sector/region			Entity's sectors/ regions versus all sectors/ regions			Min and max scores possible given sectors/regions. The gray line represents performance in line with industry standards.



ESG Profile 63



Preparedness +2

Low | Emerging | **Adequate** | Strong | Best in class

ESG Evaluation

65

A higher score indicates better sustainability. Figures subject to rounding.

Component Scores

Environmental Profile		Social Profile		Governance Profile	
Sector/Region Score	**41/50**	**Sector/Region Score**	**37/50**	**Sector/Region Score**	**22/35**
Greenhouse gas emissions	**Good**	Workforce and diversity	**Lagging**	Structure and oversight	**Good**
Waste and pollution	**Lagging**	Safety management	**Lagging**	Code and values	**Good**
Water use	**Lagging**	Customer engagement	**Good**	Transparency and reporting	**Good**
Land use and biodiversity	**Good**	Communities	**Good**	Financial and operational risks	**Neutral**
General factors (optional)	**-3**	General factors (optional)	**None**	General factors (optional)	**None**
Entity-Specific Score	**23/50**	**Entity-Specific Score**	**27/50**	**Entity-Specific Score**	**39/65**
E-Profile (30%)	**64/100**	**S-Profile (30%)**	**64/100**	**G-Profile (40%)**	**61/100**

ESG Profile (including any adjustments) **63/100**

Preparedness Summary

We assess Terrafina's preparedness as adequate with some stronger features. Terrafina's strategic priorities involve a further expansion of its industrial property portfolio in Mexico, particularly in logistics and warehouses, and green certified properties, which are its key areas of growth. Our view of its preparedness reflects a board with extensive and relevant expertise that enables the company to anticipate and capitalize on trends in the sector and region and has helped the company remain resilient to volatile economic and political cycles. Moreover, Terrafina is increasingly emphasizing sustainability in its strategy, including its target to expand its green certified property portfolio. But its overarching approach to sustainability and innovation is newly established and depends on partnerships with key counterparties.

Capabilities	
Awareness	**Excellent**
Assessment	**Good**
Action plan	**Good**
Embeddedness	
Culture	**Developing**
Decision-making	**Good**

Preparedness Opinion (Scoring Impact) **Adequate (+2)**

ESG Evaluation **65**

Note: Figures are subject to rounding.

Environmental Profile

64/100

Sector/Region Score (41/50)

Property operators' largest environmental risk exposure involves tenant use of properties, especially GHG emissions, which are mostly linked to energy use, as well as water consumption, and waste management. The sector's fixed physical assets are exposed to floods, earthquakes, and hurricanes, which are common natural hazards in Mexico.

Entity-Specific Score (23/50)

Note: Figures are subject to rounding.

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Good	**Lagging**	**Lagging**	**Good**	**-3**

Industrial REITs are inherently more exposed to environmental risks than other types of REITs, given the nature of its tenants' business operations. Terrafina's tenant base consists of auto makers (34%), industrial goods (21%), consumer goods (15%), logistics (11%), aerospace (10%), and electronics (9%), although the portfolio turnover may shift sector exposures over time. We reflect this added risk exposure through a negative three-point adjustment. However, the bulk of the company's tenants are U.S.-based multinational corporations that have their own approach to environmental risk management, although practices vary.

Terrafina's approach to GHG emissions is largely in line with industrial REITs, but progress in reducing its carbon footprint is constrained by Mexico's slow transition to renewable energy. Terrafina tracks GHG emissions for about 60% of its GLA, up from 43% in 2021, which is higher than those of domestic peers. However, the company's use of GRESB's "Like for Like" criteria covers only 30% of total GLA. In our view, the Like for Like approach enables greater data consistency and comparability, and we expect Terrafina to improve its coverage under this method. Additionally, Terrafina set a target to reduce tenants' GHG emissions 20% by 2030 (baseline 2019) largely by engaging with clients to improve energy efficiency and obtaining green certification for new developments and acquisitions. This approach is similar to those of global peers. However, Terrafina's ability to meet its GHG reduction goals is constrained by Mexico's carbon-intensive electricity grid and slow progress in renewable energy development, given the heavy regulatory changes and uncertainties in the country's energy sector recently.

Terrafina's ability to address tenant waste is constrained by weaknesses in Mexico's waste management practices. Waste in Mexico is largely collected by third-party contractors, most of which is landfilled. This, along with poorly enforced environmental regulations, impede Terrafina's ability to measure and mitigate its tenant waste impact. The company hasn't set any specific targets yet, but it's committed to develop solutions in the short term.

Terrafina's industrial assets are in regions with high exposure to water stress, while biodiversity risks emerge through new developments, which are limited. More than 50% of its properties are in intense water stress regions, which is high for the sector. The company has set a target to reduce 20% of tenant's water intensity by 2030 through several water efficiency projects, while tracking the progress should improve through water meter installations. Terrafina's biodiversity approach is standard and includes a mapping of biodiversity issues for its portfolio and a commitment to limit the impact from its assets and avoid protected natural areas.

Social Profile

64/100

Sector/Region Score (37/50)

Tenant retention is one of the primary financial drivers, while community impacts are increasingly factored into regulation and can have reputational implications for operators. REITs are not labor intensive, although workforce and safety in the value chain can be material risks. We also consider weaknesses in Mexico's social standards.

Entity-Specific Score (27/50)

Note: Figures are subject to rounding.

Workforce and diversity	Safety management	Customer engagement	Communities	General factors
Lagging	**Lagging**	**Good**	**Good**	**None**

Terrafina has consistently improved occupancy rates in the past 15 years with its focus on large multinational companies and customer engagement. In the past two years, occupancy rates remained resilient at 95%, even amid the COVID-19 crisis. It offered rental concessions, rent-free periods, or management fee waivers, which supports tenant stability through cycles. Moreover, Terrafina's portfolio is diversified among industrial tenants, with the largest tenant representing only 3.9% of GLA, and lease renewal rates are high (87%), reflecting strong partnerships with the company's large multinational tenants. Terrafina engages with tenants through an annual tenant satisfaction survey, ESG questionnaires, and webinars on sustainable practices, which improves understanding of tenant needs and sustainability preferences, although this is fairly standard. Nevertheless, the company's approach to green leases and its digital capabilities, which are becoming more advanced across the industry, remain nascent.

Terrafina's approach to community engagement involves a well-structured investment policy and engagement with local communities; however, the impact of tenants' operations is not systematically tracked. Terrafina's social investment policy defines clear selection criteria, goals, and strategies, along with metrics to monitor progress. The company makes charitable contributions to communities that are adjacent to all of its properties and addresses social issues in Mexico (such as healthcare, education, and technology access). But total contributions are relatively low. Terrafina is still developing its human rights assessment, which will be applied across its value chain, although we did not identify material impacts from tenants' operations.

Terrafina has high exposure to safety issues stemming from its tenants' industrial operations, which are not systematically managed. The company is lagging behind some global best practices, such as monitoring accidents and fatalities at its tenants' operations, although new properties must provide data, enforced through contractual clauses. While it complies with local safety standards, industrial operations have greater safety risks. Nevertheless, Terrafina conducts third-party inspections annually across all assets, and it plans to obtain health, safety, and environment (HSE) certification by 2025. We expect this will improve safety risk management.

Terrafina's workforce largely consists of external counterparties, oversight of which is limited. The company contracts with investment advisors, property management, developers, and real estate agents that directly interface with tenants. The lack of visibility into the workforce practices of these counterparties limit our assessment. Still, property managers are trained on sustainability practices and green certification, which support their ability to address tenants' increasing sustainability needs.

Governance Profile

61/100

Sector/Region Score (22/35)

Terrafina is headquartered in Mexico, which has weaker and less effective institutions, along with a higher corruption perception index, than those of developed economies. Mexico's governance standards are lower than global best practices, compliance with Code of Corporate Governance is not mandatory and its adoption is limited.

Entity-Specific Score (39/65)

Note: Figures are subject to rounding.

Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Good	**Good**	**Good**	**Neutral**	**None**

Terrafina's governance practices are stronger than Mexican standards; however, they're not fully in line with global best practices. Six out of eight of Terrafina's board members are independent (75%), which is higher than regional standards and is driven by its diversified shareholder structure (100% free float). Nevertheless, independence is constrained by the joint CEO/Chairman position because it may undermine the board's ability to oversee the company's executive team, and it can make succession issues more acute. Still, there's evidence of effective board oversight through relevant committees, including a recently established ESG committee, all of which independent board members fully chair and represent. A successful succession planning is key for the long-term effectiveness and quality of Terrafina's board of directors (six-year average tenure), which the company has identified as area of improvement.

Moreover, board members experience reflects business needs and relevant technical expertise. Terrafina's board members have extensive expertise in the real estate sector in Mexico and the U.S. and in its tenants' industries, including auto parts, manufacturing, and aerospace. However, the company is still developing its ESG expertise through training of directors, and it's still behind global companies on gender diversity, with only one woman (13%) on the board.

In line with other publicly listed companies in Mexico, combating corruption drives Terrafina's values and a comprehensive set of policies enhance ethical compliance. Integrity and conduct are enforced by an annual anticorruption certification process for all suppliers, including adherence to the Foreign Corrupt Practices Act. The Code of Ethics applies to direct employees and suppliers, and they have been receiving training to foster awareness and compliance. Moreover, Terrafina hasn't experienced corruption-related cases, which suggests its approach has been effective.

Reporting is stronger than local standards but still lags behind some global best practices, particularly in ESG data disclosure. We view favorably the company's adherence to internationally recognized frameworks and standards. However, ESG data coverage for its value chain remains limited, and similar to its peers, improving data coverage remains difficult. But Terrafina has measures in place to improve data coverage, such as through disclosure clauses in contracts and data system for tenants.

Preparedness Opinion

Adequate (+2)

Preparedness	Low	Emerging	**Adequate**	Strong	Best in class

We assess Terrafina's preparedness as adequate, reflecting a highly experienced board and an increasing emphasis on sustainability; but its approach to sustainability and innovation is still fairly nascent and dependent on its relationships with key counterparties. Terrafina's key strategic priorities involve continuing to expand its industrial property portfolio in Mexico, particularly in logistics and warehouses, and expand its portfolio of green certified properties, which are key areas of growth for the company.

A highly experienced board enables Terrafina to foresee and respond to disruption risks. For example, as early as 2019, Terrafina's board anticipated increasing demand for e-commerce and 3PL logistics, and started diversifying its property portfolio into logistics and warehouses. As a result, the company capitalized on the pandemic-induced acceleration of e-commerce and the global supply-chain bottlenecks (including logistical issues). Moreover, Terrafina has historically demonstrated sound resilience navigating through volatile economic and political cycles. We believe the board and management have identified the most probable and significant disruptive risks to the business, which they monitor on a regular basis. These include climate risk, geopolitical tensions, U.S. trade agreements, demand for green properties, and disruption in tenants' industries and supply chains. In addition, board members closely engage with regulators, governmental agencies, and industry associations on issues relevant to their tenants, such as the recent global semiconductor chip shortage and the USMCA Agreement. This enables Terrafina to better anticipate and adapt to new trends in the sector and region.

Sustainability is becoming a strategic growth area, particularly for construction of new properties and acquisitions, but its overall sustainability approach is still relatively new. Terrafina's growth strategy involves the construction of green certified properties. It is notable the company's issuance of a sustainability-linked bond with targets to obtain green certifications for all new properties and reach 15% of its GLA by 2030, which further incentivizes the company to remain accountable to its green growth agenda. However, it's in the early phase of data collection and engagement with tenants. We expect sustainability will play a more important role in the company's strategic decisions as it enhances its operational sustainability capabilities.

Partnership and engagement with contractors and tenants are key strategic enablers. In order to advance its sustainability agenda and enhance its innovative potential, Terrafina must work with its tenants and third-party contractors. These partnerships will influence the pace of sustainable practice adoption and the types of innovations that are developed. The reliance on outside parties makes establishing a culture of innovation and sustainability more challenging. However, we recognize an alignment of interests among its multinational industrial tenants and Terrafina's sustainability goals, which should help it advance its strategic sustainability agenda.

Sector And Region Risk

Primary sector(s)	Real Estate
Primary operating region(s)	Mexico

Sector Risk Summary

Environmental exposure

The most significant environmental risk for the real estate sector (real estate operators, homebuilders, developers, and social housing providers) involves mitigating climate change. This includes improving energy and water management to reduce building emissions, and enhancing the resilience of properties to climate events. The building and construction sector accounts for 39% of global carbon emissions including 28% from the energy required for heating, cooling, and lighting, and 11% from emissions associated with materials and construction processes throughout the building lifecycle (source: worldgbc.org). The sector is vulnerable to extreme climate events at the asset level, particularly inland flooding, rising sea levels and coastal floods, and hurricanes or typhoons. Properties are also subject to cold spells, heat waves, drought, and heavy rain, which can adversely affect facilities. Building construction also generates significant waste, including hazardous waste. Environmental risk varies by subsector and depends on the location, asset class, and use of the asset along with the intensity of construction activities. However, companies are increasingly enhancing their environmental performance to reduce operating costs, improve property values, and attract and retain tenants. Tenants are implementing green leases to improve their environmental footprint, by strengthening their ties with stakeholders and supporting customer requirements to adopt better environmental and social frameworks in their operations, as part of the value chain. Most tenants' customers are adopting ESG sustainability parameters; green lease structures help them to improve these parameters and enhance their sustainability framework reporting. Market dynamics and risk exposures are less a concern for social housing operators. They generally have fewer resources to address maintenance and sustainability issues and cannot reposition their assets given their mandate to serve a specific community. Low-income tenants have generally fewer available housing options, resulting in price inelasticity. In terms of environmental effects from construction and exposure to emissions and waste, social housing is similar to other private developments, but runs less risk of falling foul of regulatory standards.

Social exposure

The sector's most material social risks stem from employee health and safety during construction, tenants' requirements that buildings comply with the latest safety and environmental regulations, and local communities' perceptions of companies' safety and environmental practices. Changes in consumer behavior and demographic trends are influencing companies' operating strategies and attitudes to ownership of specific assets or developing assets, as we see more developments focus on employee safety, wellbeing, and affordable community developments. Major safety incidents at buildings can severely affect communities. Moreover, the built environment plays an important role in occupants' health, wellbeing, and productivity given people spend nearly 90% of the time indoors. Construction is another important area of risk, especially given the manual labor required from employees and subcontractors, where safety risks are significant and poor performance can weaken their social license to operate. Housing affordability is a growing concern in some markets. Social housing benefits from regulatory frameworks that translate central or local government objectives into more predictable operating environments than for private sector peers. Not-for-profit housing operators are not significantly exposed to consumer preferences as providers of safety-net accommodation; rather, we see more localized risks related to residents being opposed to public housing or negative externalities (high crime for example). Similarly, if a public housing association fails to keep its residents safe with proper housing standards, its reputation and relations with various stakeholders can be damaged, increasing risks around social cohesion and community unrest.

Regional Risk Summary

Mexico

Mexico's public institutions suffer from shortcomings that limit their effectiveness in providing basic public services, ranging from law and order to contract enforcement to proper regulation and supervision. High levels of violence and perceived corruption increase the risks of doing business. Despite regular elections and changes of government, the quality of governance has remained poor, contributing to the country's weak GDP growth in recent years. Mexico has comparatively high levels of perceived corruption, ranking 124 out of 180 on Transparency International 2020 Corruption Perceptions Index. More than half the workforce is in the informal sector, with low wages and few social benefits. The poverty rate has remained high despite a stable economy with low inflation. Mexican politics has been divisive, reflecting social gaps and divisions. Despite significant governance improvements enacted in the Capital Markets Law, dual-class share structures, cross-holdings, and pyramidal structures are common and often to the detriment of minority shareholders rights. The Code of Corporate Governance Principles and Best Practices, last updated in 2018, provides some recommendations such as the separation of the roles of CEO and chair. However, compliance with the Code is not mandatory and its adoption is limited. Local retirement fund administrators have been a strong proponent of better governance practices. In 2018, the pension regulator, Comisión Nacional del Sistema de Ahorro para el Retiro, published guidelines for funds to explicitly integrate ESG into their investment processes.

Related Research

- "The ESG Risk Atlas: Sector And Regional Rationales And Scores," published July 22, 2020
- "Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide," published July 22, 2020
- "Environmental, Social, And Governance Evaluation: Analytical Approach," published December 15, 2020
- "How We Apply Our ESG Evaluation Analytical Approach: Part 2," published June 17, 2020

This report does not constitute a rating action.