

# IMPROVING OUTLOOK DRIVEN BY CONSISTENT DEMAND AND SCARCE AVAILABILITY

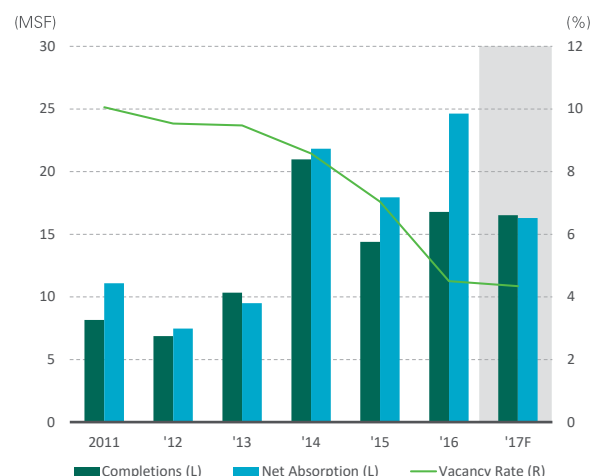


MEXICO LOGISTICS REAL ESTATE OUTLOOK | AUGUST 2017

**Summary:** *The Mexican logistics real estate market is strengthening. Geopolitical factors impacted financial markets and the economy for the last year and more. Yet, logistics real estate conditions are strong as Mexico's vacancy rate reached a new low of 3.9%. With trade uncertainty receding, competition among customers for limited available space should drive rents upward.*

**Geopolitical crosscurrents have been significant in Mexico in recent years.** The peso has been among the most volatile currencies of the last two years, selling off by 29% during 2015 and 2016,<sup>1</sup> when uncertainty in trade relations with the U.S. buffeted the market. Expectations for a modernization of NAFTA, without a border-adjustment tax or other major changes, has stabilized the region's outlook. Mexico's financial markets are among the most improved globally in 2017, even though GDP is expected to expand moderately at 2.1% this year.<sup>2</sup>

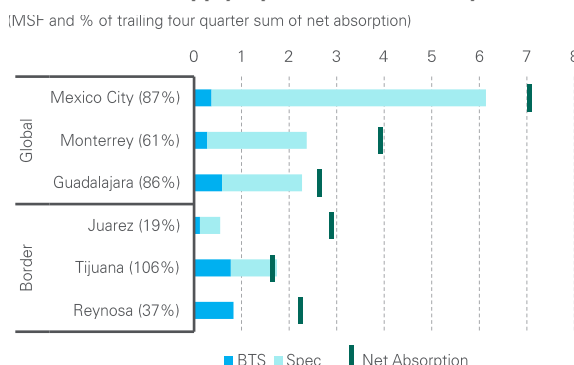
**EXHIBIT 1: Operating Fundamentals, Mexico**



Source: CBRE, NAI, Prologis Research

**Yet, customer demand has been consistent and healthy.** Net absorption in Mexico's six main logistics markets totaled 8 million square feet in the first half of 2017, a rapid clip eclipsed only by the record set in 2016, when net absorption amounted to 25 million square feet for the full year.<sup>3</sup> The national market vacancy rate for modern-grade product declined by 60 basis points year-to-date to 3.9%.<sup>4</sup> Big-box users drive demand in Mexico City, with increasing instances of e-commerce customers entering the market and scaling their distribution platforms. Along the border, established customers have continued with their expansion plans, although uncertainty around trade relations with the U.S. has reduced new market entries.

**EXHIBIT 2: Supply Pipeline vs. Demand by Market**



Source: CBRE, NAI, Prologis Research

**Peso volatility has muted market rent and value growth in the global markets.**

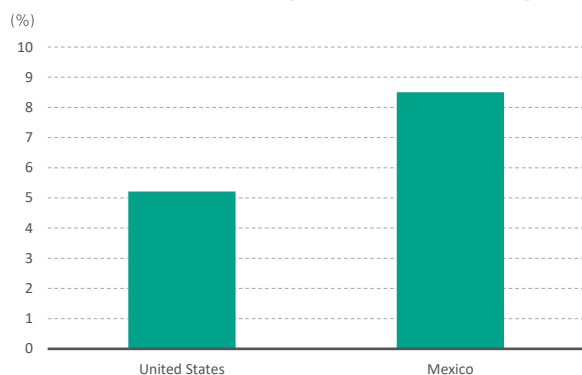
Low market vacancies typically drive strong rental growth. Indeed, potential demand seems to exceed available vacancies, especially in Mexico City, Tijuana, and increasingly in Juarez. Further, some customers have locked in preleases on speculative developments in Mexico City, an atypical practice. Yet, the trend in rental rates has been less robust. In Mexico City, and Guadalajara and Monterrey to a lesser extent, rents are quoted predominantly in dollars, but with an active and growing part of the market denominated in pesos. Recently, peso rents have escalated quickly in response to market dynamics. By contrast, dollar rent growth has stalled. The weakening of the peso in the foreign exchange market has meant that, for customers with dollar-denominated rents, rates soared when adjusted to pesos at prevailing foreign exchange rates, tempering demand for leases denominated in dollars.

**A brightening outlook as downside risks dissipate.**

The recent recovery of the peso buoys the outlook for dollar rent growth in markets where peso rents are an option (e.g., non-border markets). In fact, the peso has been strengthening throughout 2017 and the impact on rents may already be emerging. Completion of a NAFTA renegotiation is expected to help. Along the border, a return to normal demand should translate into stronger rental growth. Across Mexico, vacancies appear likely to remain low for the foreseeable future – the current pace of completions lags the pace of recent demand. Prologis Research forecasts both net absorption and completions of 16 million square feet in 2017. In this environment of healthy demand and rising rents, development activity is expected to increase.

**Relative valuations are compelling.** Cap rates in Mexico are among the highest in the world, even with much of the income denominated in dollars. The current spread between the implied cap rates of the main FIBRAs and C-Corps in Mexico with exposure to industrial real estate versus U.S. REITs is 325 basis points and notably higher than the historical average. By comparison, the spread was 100 to 125 basis points in mid-2014 prior to the selloff in emerging markets.<sup>5</sup> Market demand and occupancies are robust, pointing to improving pricing power. Notable risks are abating. Relative valuations are attractive, although the spread will not completely narrow in time; other important risks remain. The security situation has worsened in more parts of Mexico in recent years. Separately, timing is tight to close the NAFTA renegotiation ahead of the 2018 presidential election. Elevated social unrest and opposition voters add to uncertainty heading into the election.

**EXHIBIT 3: Industrial Cap Rates, Stock Price Implied**



Source: FactSet Consensus, Prologis Research

Note: U.S. implied cap rates from FactSet Consensus. Main industrial REITs include PLD, DCT, DRE, EGP, FR, LPT and STAG weighted by market cap. Mexico implied cap rates are estimates from Prologis and company filings. Main FIBRAs with industrial exposure include FIBRAPL, FIBRAMQ, TERRA and Vesta. Data as of June 30, 2017 and stock price as of August 16, 2017.

## ENDNOTES

<sup>1</sup> FactSet, Prologis Research

<sup>2</sup> Consensus Economics, Prologis Research

<sup>3</sup> CBRE, NAI, Prologis Research

<sup>4</sup> CBRE, NAI, Prologis Research

<sup>5</sup> FactSet Consensus, company filings, Prologis Research

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Prologis' research department studies operating fundamentals and investment trends and Prologis' customers' needs to assist in identifying opportunities and avoiding risk across four continents. The team contributes to investment decisions and long-term strategic initiatives, in addition to publishing white papers and other research reports. Prologis publishes research on the market dynamics impacting Prologis' customers' businesses, including global supply chain issues and developments in the logistics and real estate industries. Prologis' dedicated research team works collaboratively with all company departments to help guide Prologis' market entry, expansion, acquisition and development strategies.

## ABOUT FIBRA PROLOGIS

FIBRA Prologis is the leading owner and operator of Class-A industrial real estate in Mexico. As of June 30, 2017, FIBRA Prologis comprised 194 logistics and manufacturing facilities in six industrial markets in Mexico totaling 34.2 million square feet (3.2 million square meters) of gross leasable area.

