

Tight market conditions offset growing macroeconomic headwinds



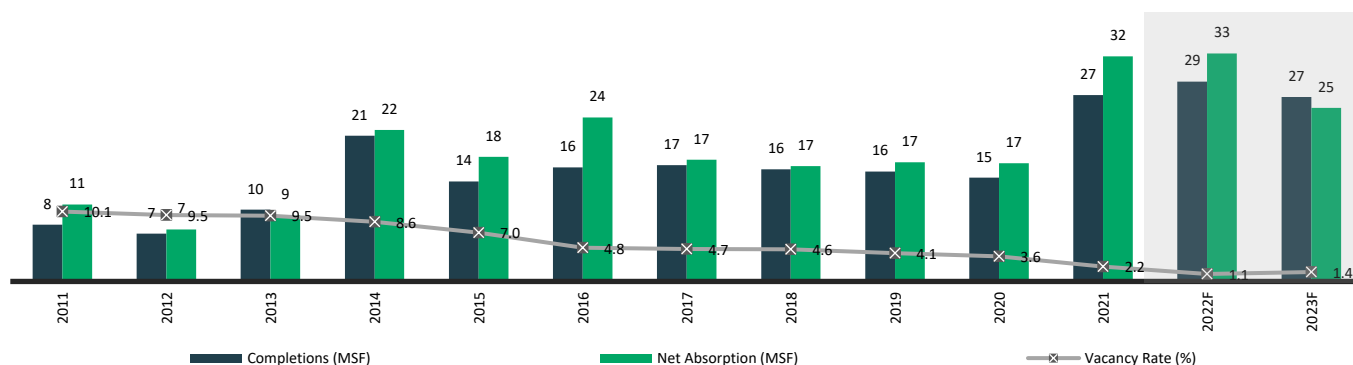
Park Grande, Mexico City

Overview

Logistics real estate demand has been growing faster than expected in 2022, fueled by accelerating industry trends over the previous quarters, including nearshoring and e-commerce adoption. Supply has a hard time keeping pace, as developers face longer entitlements, higher costs, scarcity of land, and limited availability of utilities. Essentially fully occupied market conditions are expected to persist through 2023. Even as economic conditions deteriorate, the sector is expected to remain resilient and counter-cyclical. Rent growth should exceed inflation, vacancies should keep tight, and assets in primary markets are expected to remain stable.

Exhibit 1

FIBRA PROLOGIS COMPETITIVE ENVIRONMENT: MARKET FUNDAMENTALS



Source: CBRE, NAI, Market Analysis, Solili, and Prologis Research.

Supply is elevated but still lagging behind demand due to stringent supply barriers. Development reached its quarterly peak in Q4 2021, followed by the highest six-month figure in 1H22 as developers responded to increased demand momentum. However, strategic land is scarce in metropolitan markets, and securing essential utilities in new sites in the Northern markets is becoming harder.

Supply barriers include longer entitlement periods, rising construction costs (10% in 1H22), and expensive materials that need to be secured several months before vertical construction. In Mexico City and Guadalajara, strategic land is becoming scarce, and developers are looking to expand, exploring further sub-markets or expensive covered land sites in the metropolitan area. For Tijuana, Juarez, Monterrey, and Reynosa, land options with sufficient energy and water availability are limited.

The current data suggests that 2022 will be the year with the most completions (Exhibit 1), with the 2H22 accelerating deliveries compared to the 1H22 (16MSF v. 12 MSF).

Fundamental shifts in demand continue trending. Supply chain reconfiguration and retailing drifts due to changes in habits of consumption will continue to fuel demand heading into 2H22. We expect that overall demand in Fibra markets may reach a new record with 33 MSF in 2022 (Exhibit 1), beating our previous forecast for the end of the year, mainly due to a more relevant nearshoring activity and its steep demand for manufacturing spaces experienced in the 1H22.

- **Nearshoring** is the strategy of firms to relocate their production through the de-globalization of manufacturing processes, mainly from Asia, favoring the regionalization of supply chains. Northern markets in Mexico have been the central pole of attraction due to their proximity to the U.S., the trade agreements within North America, and the qualified and available labor force.

CBRE data as of 1Q22 shows that nearshoring demand is set to reach a new record-high, doubling last year's figure. That implies that 40% of total demand in Mexico may come from nearshoring in 2022. Nearshoring is expected to continue accelerating and driving demand in the following quarters as global bottlenecks and rising transportation costs are not normalized.

Looking into the details of nearshoring:

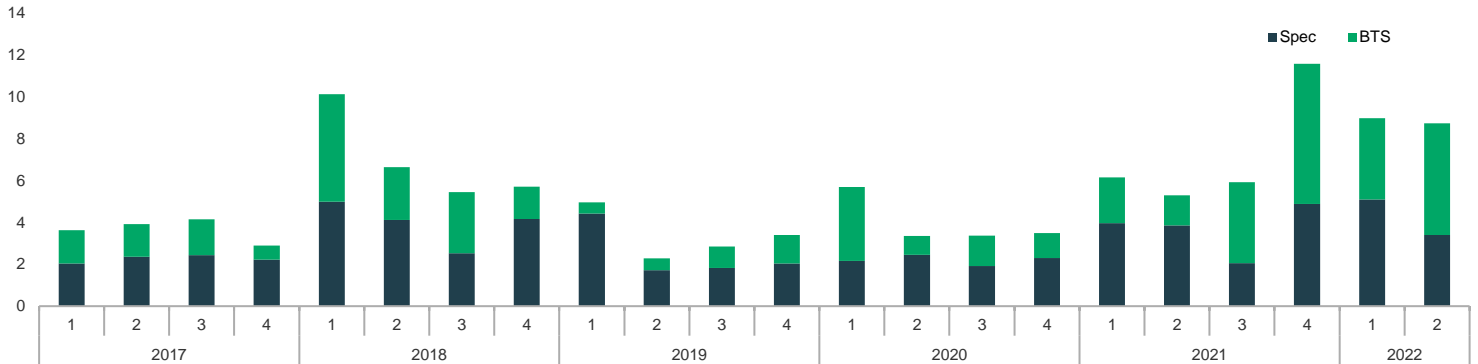
- The primary industries are Auto, Furniture, Electronics & Home Appliances
 - Chinese firms account for half of the nearshoring deals since 2019, followed by North American and European countries
 - Monterrey, Juarez, and Tijuana are the main markets attracting nearshoring, accounting for almost $\frac{3}{4}$ of nearshoring demand
- **E-commerce & logistics** demand for space in Mexico City, Monterrey, and Guadalajara represented 45% of overall leasing

transactions during the 1H22. These industries' main drivers are regional consumption and consumer indicators such as retail sales, which have shown positive year-to-date results.

Looking forward into the 2H22 and 2023, we expect the positive consumption trends to flatten due to the headwinds in consumption, like high inflation and rising interest rates. Nevertheless, the adoption of new consumer habits and the relatively low penetration of e-commerce to total retail sales in Mexico (10%-11%, according to Euromonitor) are expected to continue driving the demand for space.

Exhibit 2
DEVELOPMENT STARTS, MEXICO

MSF



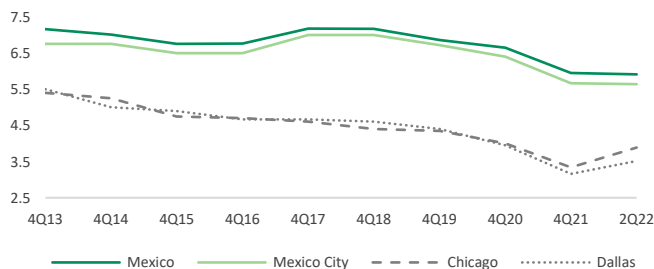
Source: CBRE, Solli, and Prologis Research.

Low vacancies are creating urgency for customers to pre-lease any potential availability. Tenants are securing space fast to prevent competing rents on a new development in the market. The market has also experienced a limiting vacancy for new deliveries as tenants are trying to secure their space with BTS (Exhibit 2), and most Spec developments are being delivered pre-leased. Vacancy should reach its lower point this year since four of six Fibra markets are forecasted to end the year below 1%. Vacancy in Mexico City and Monterrey will continue to be higher (2%-3%) because of the significant pipeline to be delivered during the 4Q22.

BTS starts, and pre-leased Specs will continue in the 2H22 as tenants and developers try to secure the limited available sites in markets like Monterrey and Juarez. For Tijuana, we expect a significant decrease in starts in 2H22 since there is no land available.

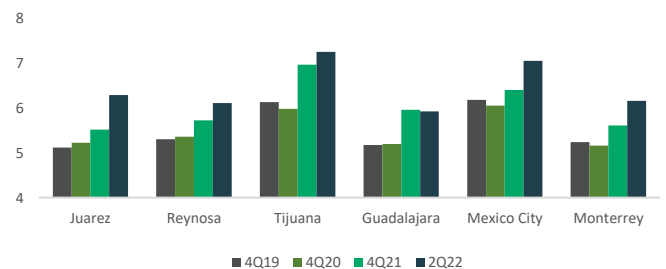
Rising interest rates, replacement costs, and macroeconomic uncertainty should push development to core markets with solid fundamentals, in which rents and scalability justify profitability margins.

Exhibit 3
PRIME STABILIZED CAP RATES
(%)



Source: Prologis Research. Note: House view on cap rates and rents.

Exhibit 4
RENTS
(US\$/SF/YEAR)

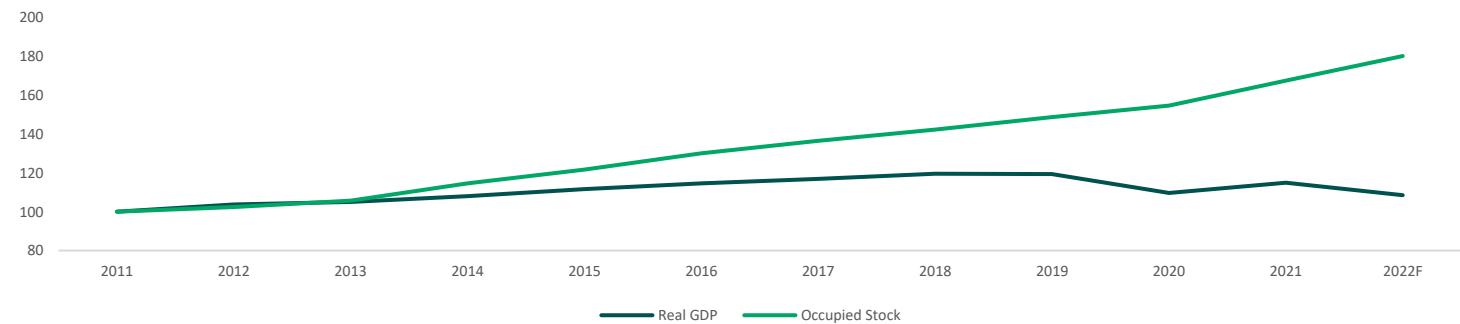


Pressure on cap rate expansion is increasing from global uncertainty, rising interest rates, and rent growth. In this environment, cap rates are expected to expand to maintain a balanced risk profile in the sector. Given the supply barriers, tightened and rising replacement costs vs. valuations, and supporting fundamentals driving rent growth, values are not expected to compress in the foreseeable future.

Rent growth. Market rents increased ~7.0% during the 1H22 and are expected to grow at a more moderate pace of 2.5% for the year's second half (Exhibit 4). The expected pipeline completion in Mexico City and Monterrey should flatten overall rent growth compared to the first months of 2022. Market fundamentals and positive dynamics justify a spread of 100-200 basis points over inflation.

Logistics real estate outperforms the economic cycle. Since 2011, real GDP in Mexico has risen 8% vs. 80% growth of occupied modern logistics real estate stock in the same period, demonstrating sector resilience. Nearshoring acceleration and low e-commerce penetration will continue playing a role in the demand for space in the relevant logistic markets in the country.

Exhibit 5
FUNDAMENTAL OPERATING CYCLE, MEXICO



Source: International Monetary Fund, Consensus Economics and Prologis Research

Forward-Looking Statements

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Fibra Prologis

Paseo de los Tamarindos 90 Torre 2 Piso 22
Bosques de las Lomas
CDMX 05120
Mexico

www.prologis.com

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