

MEXICO LOGISTICS REAL ESTATE OUTLOOK | Third Quarter 2019

Logistics Real Estate Operating Environment Steady Amid Slowing Cyclical Growth



Overview

Logistics real estate operating conditions in Mexico continue to reflect the sector’s multiple structural demand drivers, which include linkages to stable growth in the United States and demographics in Mexico City. Cyclical economic conditions remain fluid and slowing domestic and global growth remain tail risks to monitor. Indeed, geopolitical uncertainty is a critical consideration, as reflected in attractive relative valuations.

Mexican logistics real estate is supported by multiple structural drivers that will unfold gradually over time. These drivers include:

1. a large and growing consumer market in Mexico City, increasingly serviced by e-commerce companies;
2. a vast undersupply of modern logistics stock in Mexico City with pronounced supply barriers;
3. proximity and established supply chain linkages to the United States; and
4. a production shift away from long global supply chains to shorter, more regional supply chains to reduce potential disruption risk, improve time to market and reduce administrative costs.

Each of these drivers represents a favorable trend for Mexico and North American producers alike.

However, the industry’s structural drivers are not completely decoupled from cyclical economic growth. Synchronizing and slowing global economic growth in export-oriented countries is a

key risk to monitor, particularly in Mexico’s light-assembly markets. Domestic economic growth expectations have softened in recent months, adding near-term tail risks.

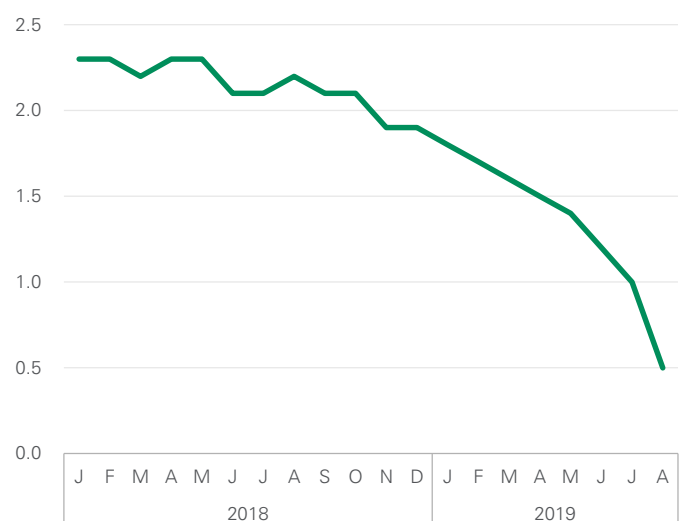
Nevertheless, the overall operating environment is steady, led by the border markets, and is significantly outpacing the overall economy with demand growth at more than 4% over the last four quarters.¹ Demand growth remained positive in the second quarter of 2019, albeit slower, as structural drivers continued to lift demand amid geopolitical uncertainty and moderate economic growth. Market vacancy in Mexico’s six main logistics markets remains below its normalized equilibrium rate. However, operating performance has been led by the border markets in 2019, where market vacancy contracted by 200 basis points year-over-year and currently stands at or below 2% in Juarez and Tijuana.² In the three main global markets of Mexico City, Monterrey and Guadalajara, market conditions remain mixed and market vacancy continues to normalize. In Mexico City, demand slowed in the second quarter of 2019, but overall market vacancy for modern product remains below 3%.³

Exhibit 1
REAL GDP GROWTH, MEXICO & UNITED STATES
(%, Dec/Dec)



Source: Consensus Economics, Prologis Research

Exhibit 2
2019 REAL GDP GROWTH EXPECTATIONS, MEXICO
(%)



Note: Prologis Research's estimate of normal logistics real estate demand implies net absorption as a percentage of modern stock at 4.5% in the six main markets, and comparable to the demand rate realized in 2018.

Source: Consensus Economics, Prologis Research

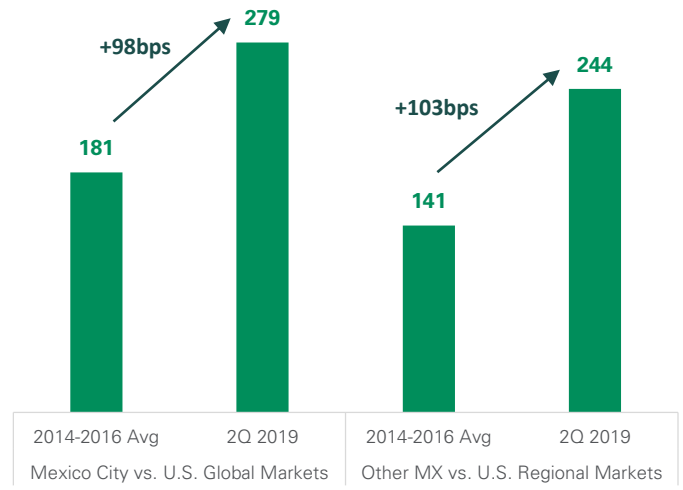
Supply risk is concentrated in Guadalajara and Monterrey.

Development activity in Monterrey and Guadalajara remains strong. Projects currently under construction relative to trailing four quarters of net absorption is elevated--a barrier to market growth.⁴ Most supply under construction in Monterrey is ill-conceived building specs for modern logistics customers. Indeed, demand remains the key operating metric to monitor going forward.

Rent and valuation growth are positive but lag behind most other regions of the world. Moderating business sentiment and soft consumption indicators were drags on market rental growth momentum in consumption-oriented markets. In the border markets, market rental growth has been a stabilizing factor for overall national conditions.

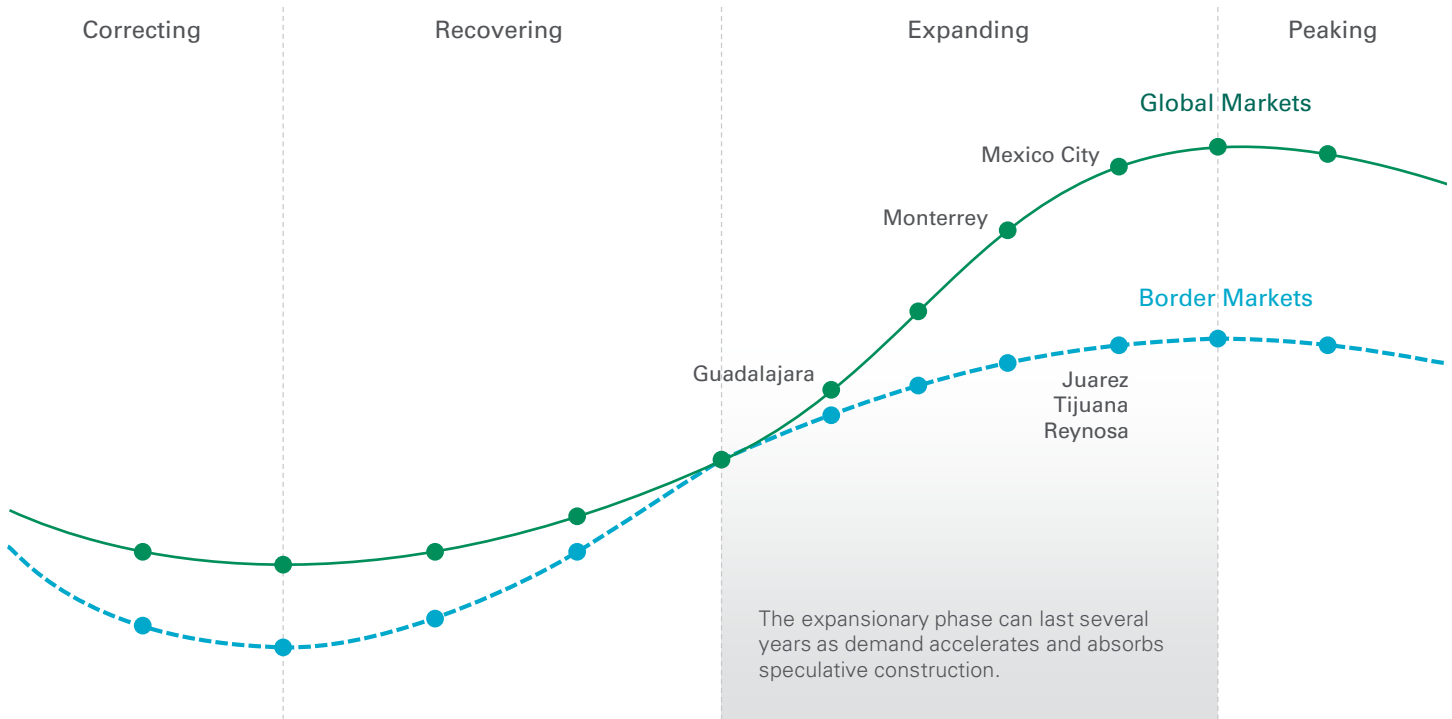
Attractive relative returns reflect an environment of elevated uncertainty. Logistics real estate valuations in Mexico remain attractive on a historical global relative basis. Modern-grade (Prime/Core) cap rate spreads between Mexican markets and U.S. peer markets have trended ~100 basis points higher than the average spread between 2014 and 2016.

Exhibit 3
PRIME/CORE CAP RATE SPREAD, MEXICO VS. U.S. PEERS (BPS)



Source: Prologis

Exhibit 4
FUNDAMENTAL OPERATING CYCLE, MEXICO



Source: Prologis Research

Endnotes

1. CBRE, NAI and Prologis' view of modern stock
 2. CBRE, NAI and Prologis' view of modern stock
 3. CBRE and Prologis' view of modern stock
 4. CBRE, NAI and Prologis' view of modern stock
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Forward-Looking Statements

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FIBRA Prologis is a leading owner and operator of Class-A industrial real estate in Mexico. As of June 30, 2019, FIBRA Prologis was comprised of 190 logistics and manufacturing facilities in six industrial markets in Mexico totaling 34.8 million square feet (3.2 million square meters) of gross leaseable area.

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