

MEXICO LOGISTICS REAL ESTATE OUTLOOK | Second Quarter 2019

Logistics real estate operating environment fueled by durable structural drivers



Overview of Tabacalera neighborhood and reforma area, around monumento a la Revolución

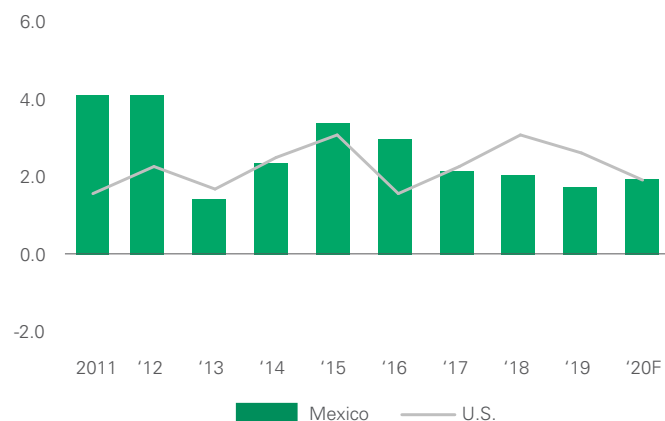
Mexico

Durable logistics real estate operating conditions in Mexico reflect the strength of the sector's structural demand drivers. Rising affluence, e-commerce and an undersupply of modern logistics stock to service consumers in Mexico City, as well as economic linkages to stable growth in the United States, demand tailwinds. Geopolitical uncertainty is a critical consideration, however, as reflected in attractive relative valuations.

Structural demand drivers of Mexican logistics real estate continue to advance and present a unique opportunity.

Mexico's logistics real estate market is a growth industry with diverse and unique demand drivers. These drivers unfold gradually over time and include: (i) a large and growing consumer market in Mexico City, increasingly serviced by e-commerce companies; (ii) a vast undersupply of modern logistics stock in Mexico City with pronounced supply barriers; (iii) proximity and established supply chain linkages to the United States with USD-denominated leases in the border markets; and (iv) a production shift away from long, global supply chains to shorter, regional supply chains to reduce potential disruption risk, improve time to market, and reduce administrative costs are favorable trends for Mexico and North American producers.

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

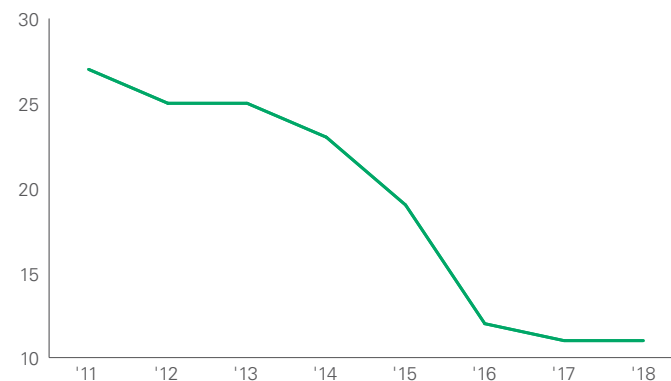


Source: Consensus Economics, Prologis Research

However, uncertainty surrounding near-term business activity has been a drag. Soft and slowing economic growth in Mexico is underpinned by volatile business conditions. Economic growth in Mexico is increasingly moving at two speeds. Overall, real GDP in the fourth quarter slowed to 1.2% annualized growth.¹ However, goods-producing sectors' output (e.g., manufacturing, construction, mining) contracted by 4.3%—a reflection of weak business confidence most likely partially impacted by U.S. business sentiment and equity performance during

the period. Indeed, Mexico business confidence has since rebounded modestly in the first quarter of 2019, in line with U.S. financial market performance. Services (e.g., wholesale and retail trade) offset the weak industrial performance, expanded by 3.4% during the fourth quarter of 2018. Strong services conditions more closely aligned with historically high consumer confidence, which stood at the highest reading on record in February 2019.²

Exhibit 2
VACANT STOCK IN MONTHS OF NORMAL DEMAND, MEXICO
(Months)



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: CBRE, NAI, Prologis Research

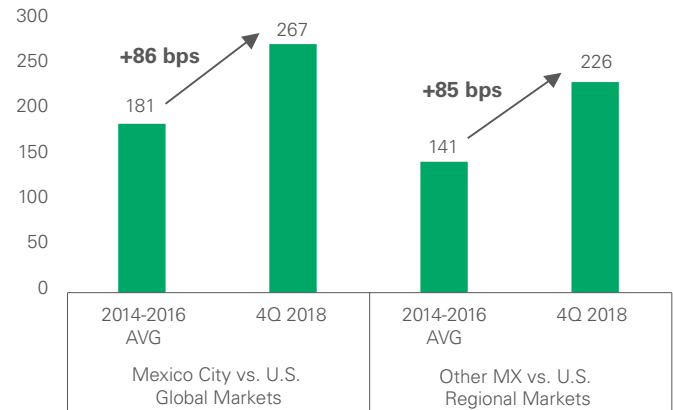
Dual-speed economy could impact logistics real estate demand.

Mexican logistics real estate operating conditions are healthy. Modern vacant stock remains low in the six main logistics markets at 4.2%, and is flat year-over-year. Solid consumption growth and high supply barriers in Mexico City south of the tollbooth in the CTT corridor has kept market vacancy low and near 2%. Border markets also remain stable with vacancy near 3.5%. However, recent labor tensions pose a unique threat to the leasing environment in the manufacturing-oriented markets, and volatile business conditions for goods-producing sectors are key risks to monitor.

Oversupply risk is more nuanced, and less concerning, than the data suggests. Although development activity in Mexico increased with 13.5 million square feet currently under construction, a handful of development trends temper oversupply concerns: (i) current market vacancy remains less than one year of forecasted annual logistics real estate demand and development activity is a response to positive supply/demand imbalance in recent years; (ii) gaining energy access for new facilities is increasingly challenging, which extends the amount of time required to complete projects, and may stall future development starts; and (iii) a notable share of ill-conceived facilities remain under construction, particularly in Monterrey, and do not compete with modern logistics facilities. In Guadalajara, risk of oversupply permeated the market over the last year, and undisciplined supply remains a forward risk.

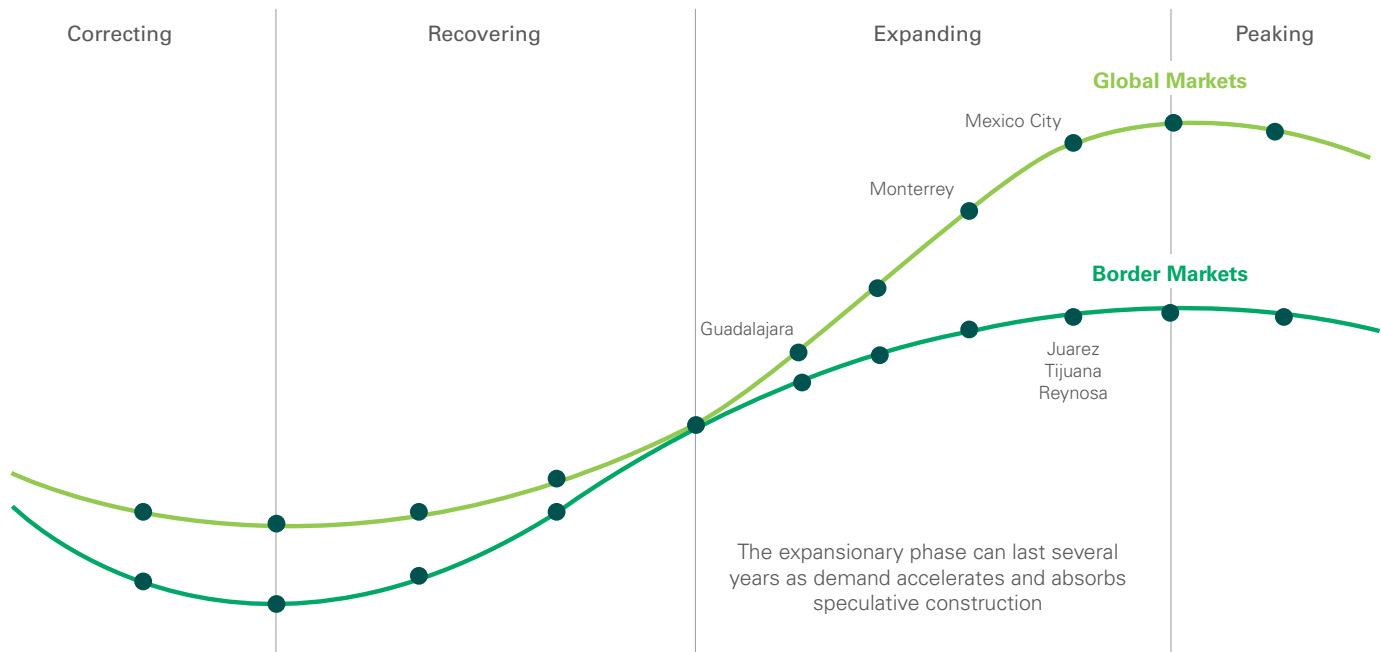
Attractive relative returns reflect the elevated business uncertainty. Tempered business confidence grew more negative over the last year. Labor tensions in Matamoras and potential upward pressure on costs are evolving and raise uncertainty for operating conditions in the production markets going forward. Favorable dynamics include the U.S. Fed policy, as a potential pause in future rate hikes could signal opportunity for emerging market capital flows. Relative returns in Mexico remain attractive. Modern-grade (Prime/Core) cap rate spreads between Mexican markets and U.S. peer markets have trended ~85 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. INEGI, Prologis Research
2. INEGI, Prologis Research
3. CBRE, NAI, Prologis' view of modern stock. Market operating metrics including market stock, vacancy, net absorption and completions are provided by surveys of Prologis' local market officers conducted by Prologis Research and informed by third-party data providers such as CBRE and NAI. These stats are real-time best estimates leveraging Prologis' local expertise on the modern logistics market – inclusive of only those facilities with advanced functional features and/or superior locations near to transit infrastructure or major population based – and deemed to be competitive with Prologis.

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FIBRA Prologis is a leading owner and operator of Class-A industrial real estate in Mexico. As of December 31, 2018, FIBRA Prologis was comprised of 200 logistics and manufacturing facilities in six industrial markets in Mexico totaling 36.0 million square feet (3.3 million square meters) of gross leaseable area.