

Supply Versus Demand: Competition Intensifies for Logistics Real Estate



Prologis Park Grande, Tepetzotlan, Mexico.

Overview

Current logistics real estate operating conditions reflect strong demand drivers, including growing e-commerce and top-tier e-fulfillment capacities. Meanwhile, supply is struggling to keep pace due to the fastest increase of replacement costs seen in years. As cyclical economic conditions ramp up, the effect of the COVID-19 Delta variant on consumption and inflation are risks to monitor.

The outlook for the second half of 2021 sets the stage for demand outpacing supply at record levels, prompted by low vacancy and higher rents. Multiple structural drivers that have been unfolding since 2020 support this view. These drivers include:

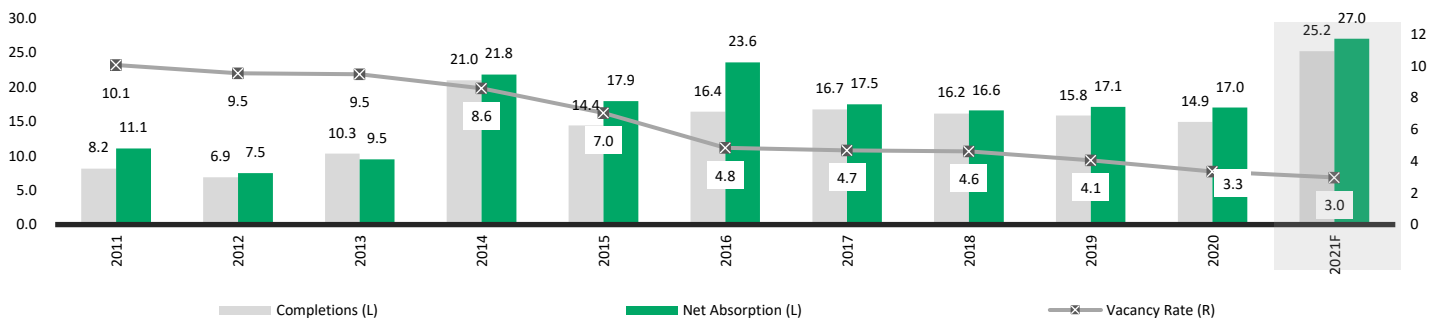
1. Increased penetration and sales serviced by e-commerce in significant markets such as Mexico City, which has a vast undersupply of modern logistics stock.
2. Pronounced supply barriers in border markets (primarily Tijuana and Juarez), with land and energy the most significant.
3. Acceleration of nearshoring and a production shift away from long global supply chains to regional supply chains to reduce potential disruption risks.
4. A spike in replacement costs (land, soft costs, materials) and inflation.

These drivers reveal a favorable scenario for low vacancy, rising rents and increasing real estate values.

Exhibit 1

FIBRA PROLOGIS' COMPETITIVE ENVIRONMENT: DEMAND AND SUPPLY

(Sqft M, %)



Source: CBRE, NAI and Prologis Research view of modern stock.

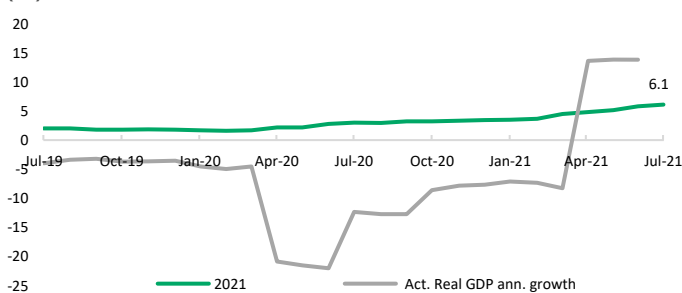
The logistics industry's structural drivers seem to have coupled with cyclical economic growth after decoupling and maintaining resiliency during the 2020 turndown. In recent months, domestic economic growth expectations have strengthened, mainly due to exports derived from activity in the U.S., lowering near-term tail risks in Mexico.

General inflation is expected to remain above the central bank's range, which is already more hawkish in its view on the target interest rate.

Exhibit 2

REAL GDP GROWTH: EXPECTED '21 VS ACTUAL

(%)

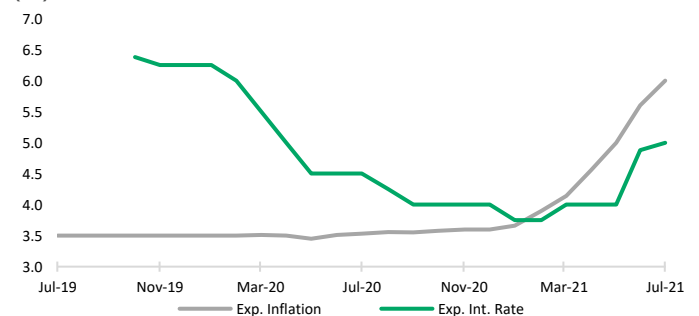


Source: Banco de Mexico

Exhibit 3

EXPECTED INFLATION AND TARGET RATE '21

(%)

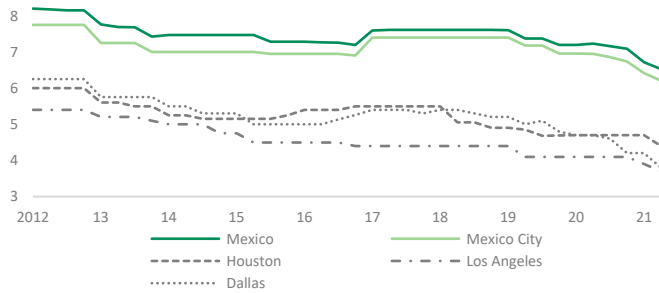


This is reflected in 1) a higher cost of leverage for development projects and 2) narrower spreads between the risk-free rate and the cap rates that have

been compressing in light of challenging supply barriers and higher replacement costs. These factors may reduce appetite among typically non-industrial competitors given that new investors initiated development projects during the pandemic, thus broadening the gap between supply and demand in the coming quarters.

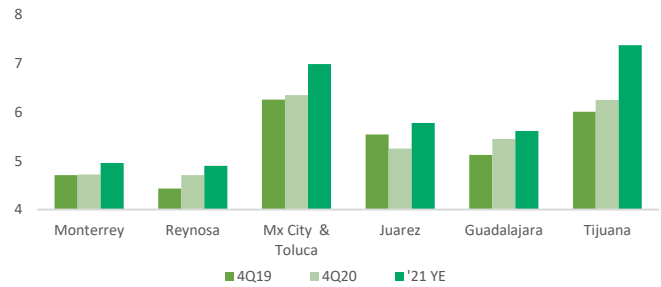
Rent and valuation growth in Mexico is positive but lags behind other markets. A slow recovery in business sentiment and consumption indicators are dragging market rental growth momentum in consumption-oriented markets. Market rental growth and values have seen more robust growth from linkages to light-manufacturing supply chains in the border markets. For 2H21, the aforementioned conditions are expected to be the main drivers that will narrow the rent and value growth gap when compared to other markets such as the U.S.

Exhibit 4
CAP RATE COMPRESSION COMPARISON (%)



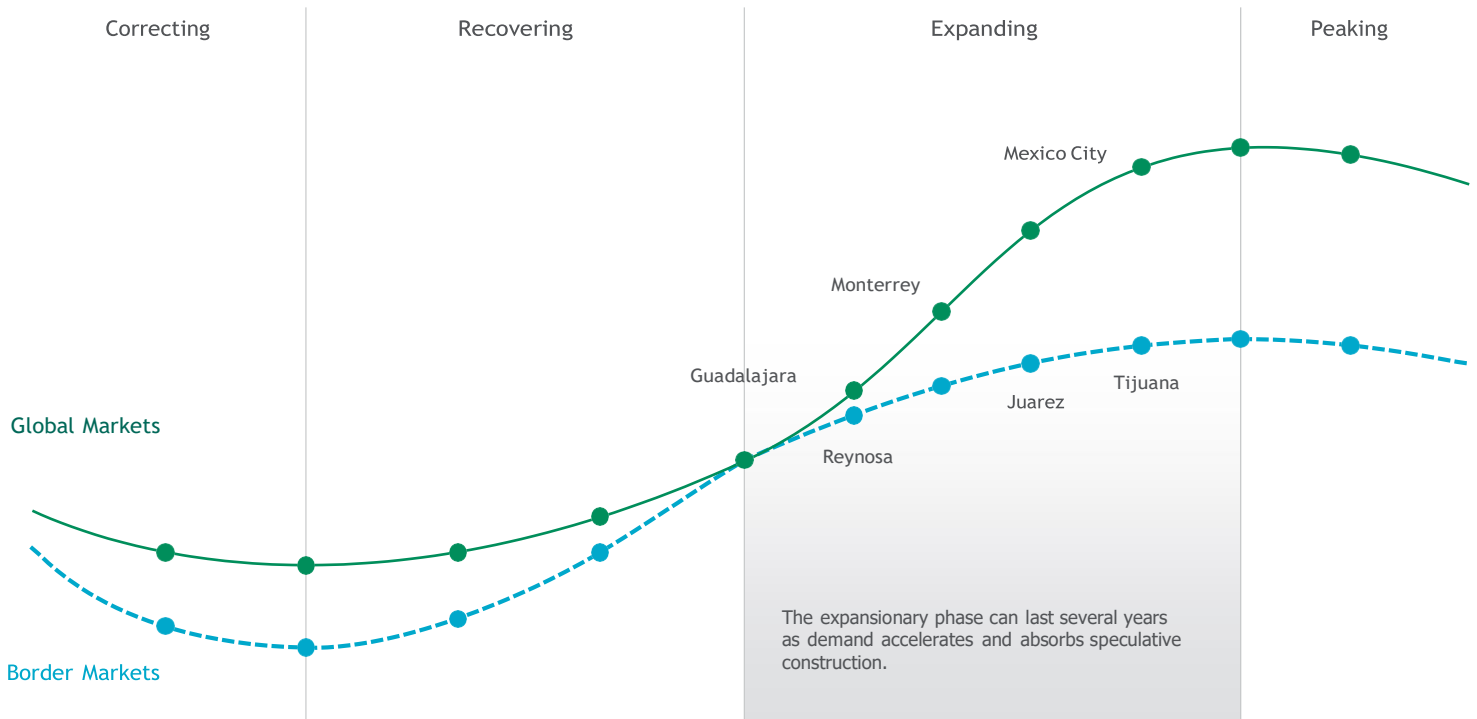
Source: CBRE and Prologis Research

Exhibit 5
AV. MARKET ASKING RENT CLASSA (\$US per sqft per year)



Supply risk is concentrated in Monterrey (global markets) and Juarez (border markets). Net absorption last-twelve months in Monterrey and Juarez surpassed completions, nevertheless remain as the markets with most vacancy among their regions during 2Q21 (6.6% and 1.6%). Demand drivers in Monterrey (mainly nearshoring) and supply barriers in Juarez (energy and land) are key operating metrics to monitor going forward. Vacancies are expected to be lower at year-end 2021 in Monterrey (5.7%) and slightly higher in Juarez (2.3%) given projected deliveries of logistics and industrial space.

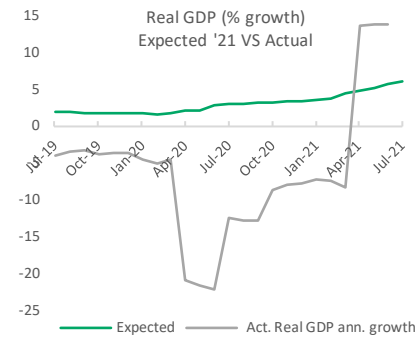
Exhibit 6
FUNDAMENTAL OPERATING CYCLE, MEXICO



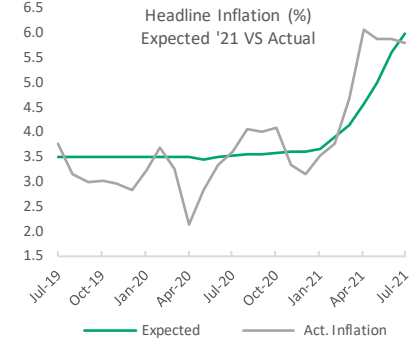
Source: Prologis Research

MACRO DASHBOARD

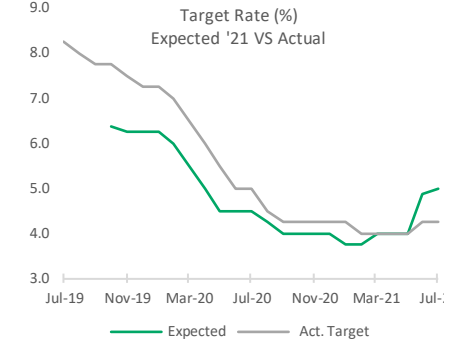
macro indicator (1)



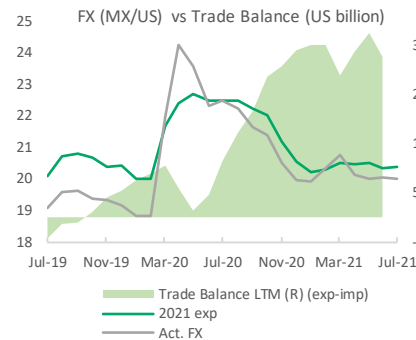
macro indicator (1)



macro indicator (1)



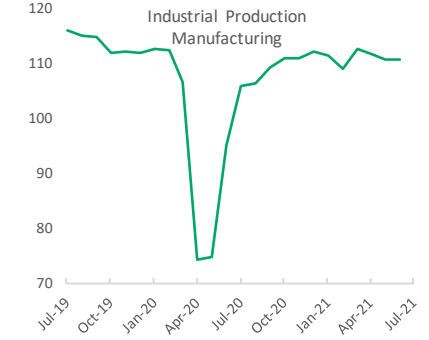
macro indicator (1,2)



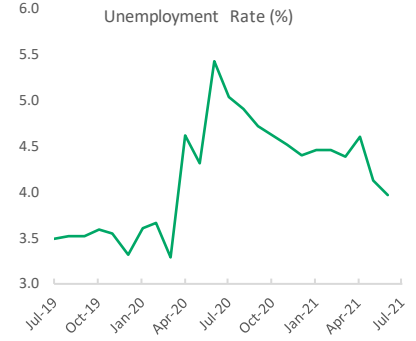
producer indicator (3)



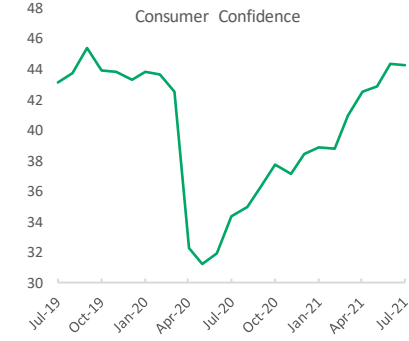
producer indicator (2)



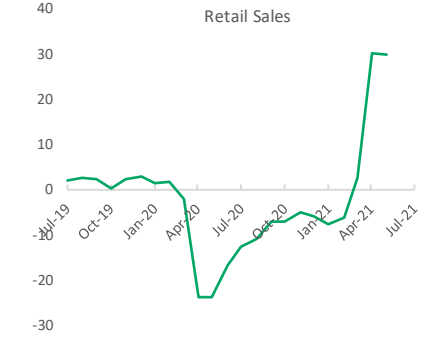
consumer indicator (2)



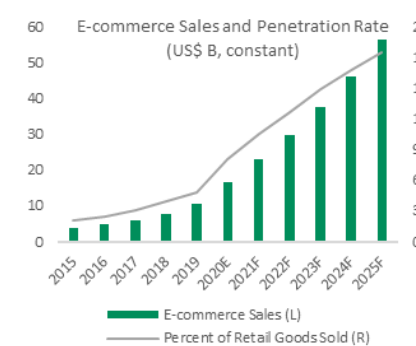
consumer indicator (2)



consumer indicator (3)



consumer indicator (4)



Sources: 1) Banco de Mexico 2) INEGI 3) Bloomberg 4) Euromonitor

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