

MEXICO LOGISTICS REAL ESTATE OUTLOOK | Second Quarter 2018

Growth drivers aligned, driving logistics real estate



Mexico

Overview: The logistics real estate operating environment improved considerably between 2015 and 2018 as structural drivers—particularly rising consumerism—continued to support demand despite modest economic growth and rising political uncertainty. Deterioration of the peso has varied implications for Mexico, and the peso’s decline poses a risk to rental growth in certain markets.

Mexico’s operating environment remains healthy. The national market vacancy rate currently stands at 3.9% and is unchanged on a year-over-year basis.¹ The demand cycle continues to be led by Mexico City, as market vacancy remains among the lowest in the world. A rising share of customers in Mexico City are locking into long-term lease structures as rental rates rise for modern, class-A assets. Pre-leasing of speculative development further lowers risk for the asset class. Scarcity of developable land south of the tollbooth should be a catalyst for future replacement cost rental growth—a positive tailwind for net operating income.

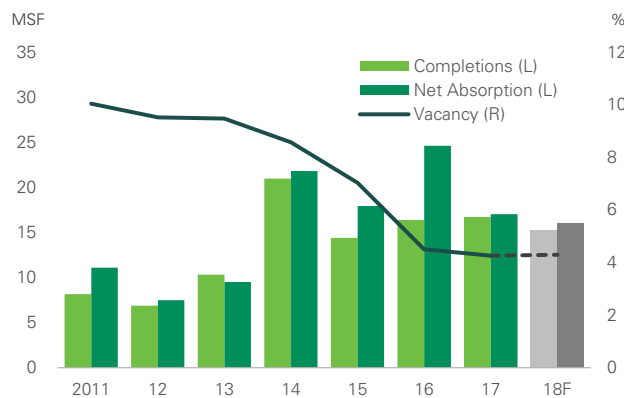
Mexican logistics real estate growth is underpinned by multiple structural drivers. Structural changes unfolding across Mexico have allowed demand growth for logistics real estate to notably outstrip modest economic growth throughout the current cycle. Prologis Research anticipates this trend to continue in 2018, as logistics real estate demand is expected to advance by 4.4%—2X the pace of broader economic growth.² Three structural trends shaping operating conditions include:

1. **Changing demographics**, particularly rising affluence and a young urban population entering the workforce
2. **Vast undersupply of modern stock** suitable for consumer-oriented distribution space
3. **Rapid growth of e-commerce**, as customers find success tailoring their e-tailing strategies³

4. **Strong supply chain links to robust U.S. growth is proving to be durable in production-oriented markets.** Despite the uncertainty surrounding the NAFTA renegotiations, established value chains built over the last 20 years continue to advance and meet current customer growth. Development activity in the border markets remains disciplined while demand continues to be led by local businesses currently established in the three border markets. Positive supply/demand imbalance along the border has existed since 2015 and should continue in 2018, driving market vacancy below 4%. Value creation along the border has picked up in the last six months, led by Tijuana, due to the outperforming market rental growth and widening in-place-to-market rents. Although NAFTA renegotiations seem likely to extend into 2019, business activity remains solid to date.

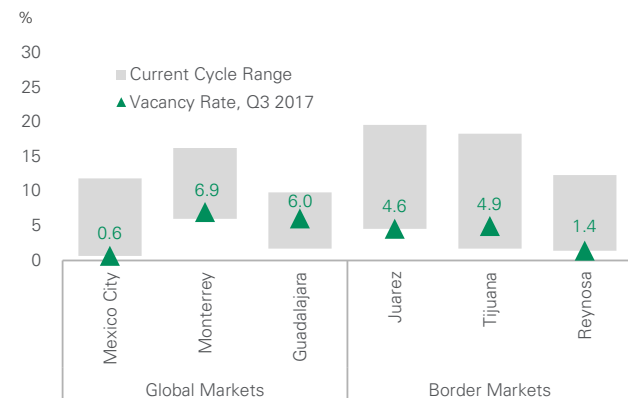
Development cycles in Guadalajara and Monterrey provide near-term headwinds. Undisciplined supply pipelines in Guadalajara and Monterrey continue to provide softness in the operating environment. Guadalajara has seen several projects begin at once among new entrants particularly in Chapala, an exurban submarket near the airport with low land scarcity. In Monterrey, much of the excess supply continues to be ill-configured and does not meet modern product standards for disciplined customers. The supply cycle in the border markets remains disciplined, as the geopolitical uncertainty has impacted supply pipelines more than the demand.

Exhibit 1
OPERATING FUNDAMENTALS, MEXICO



Source: CBRE, NAI, Prologis Research

Exhibit 2
VACANCY RATE, MEXICO



Source: CBRE, NAI, Prologis Research

It is too early to tell how campaign rhetoric will evolve into enacted policy. Andres Manuel Lopez Obrador performed stronger than expected in the Mexican presidential election and secured sweeping control of congress and local offices. Pejenomics will face limited opposition as a result. Initial post-election rhetoric helped to temper investor concerns and financial markets. The reform campaign is likely to begin with an aim to boost social and infrastructure spending. Financial markets appear to be pricing-in only incremental risk and taking a wait-and-see approach. As is the case in most elections, a disconnect between campaign rhetoric and enacted policy could emerge.

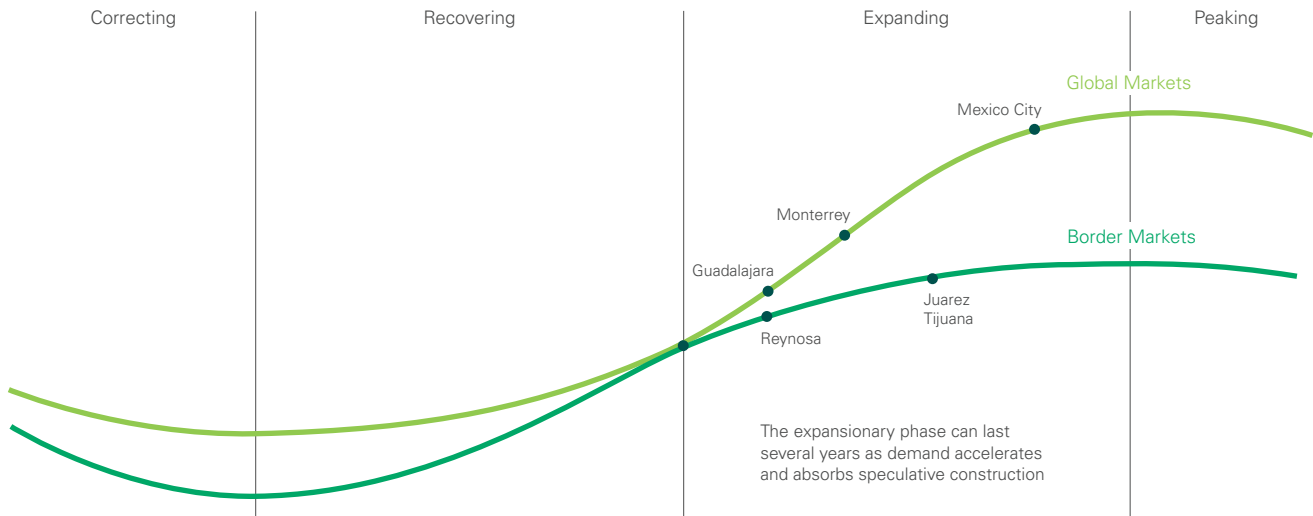
Mexican investment returns remain steady and attractive on a relative and absolute basis. Core logistics cap rates were flat over the last 12 months and stand at 7.6%.⁴ Cap rate spreads have a moderately wider margin than normal to U.S. cap rates, driven by further cap rate compression across the U.S. and rising political uncertainty in Mexico. The spread between U.S. and Mexico core cap rates has widened by around 60 basis points since Q2 2016.⁵ FIBRAs currently do not trade at premiums to NAV, which suggests the value discount could take time to play out but nonetheless remain an attractive opportunity for investors in search of yield.

Exhibit 3
CONSTRUCTION STARTS, MEXICO



Source: Prologis Research
Coverage: Six main logistics markets include Mexico City, Monterrey, Guadalajara, Juarez, Tijuana and Reynosa

Exhibit 4
FUNDAMENTAL OPERATING CYCLE, LATIN AMERICA



Source: Prologis

Endnotes

1. CBRE, NAI and Prologis' view of modern stock
2. Consensus Economics, Prologis Research
3. Electronic retailing (e-tailing) can include B2B and B2C sales of products and services and refers to businesses tailoring their traditional business models
4. Prologis house view
5. Prologis house view

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FIBRA Prologis is a leading owner and operator of Class-A industrial real estate in Mexico. As of June 30, 2018, FIBRA Prologis was comprised of 196 logistics and manufacturing facilities in six industrial markets in Mexico totaling 34.6 million square feet (3.2 million square meters) of gross leaseable area.

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