

PROLOGIS U.S. INDUSTRIAL BUSINESS INDICATOR™ LOGISTICS REAL ESTATE DEMAND EXCEEDS EXPECTATIONS



LOGISTICS REAL ESTATE DEMAND EXCEEDS EXPECTATIONS | JULY 2016

Demand for logistics real estate continues to outpace economic growth, with net absorption in the first half of 2016 marking the strongest start to the year since 2000. Net absorption totaled 125 million square feet during this time, in spite of mixed economic indicators and financial market volatility.¹ With logistics real estate occupiers leasing space more quickly than new supply is delivered, the national vacancy rate declined 20 basis points to 5.2 percent in the second quarter of 2016. Improvement in the latest reading from Prologis' proprietary index of customer activity, the U.S. Industrial Business Indicator™ (IBI), reflects accelerating growth and a high level of space utilization.

With the IBI and some economic indicators firming in June, the outlook for cyclical demand is positive. Additionally, structural trends such as expanding e-fulfillment needs should continue to augment demand. At the same time, development activity, while increasing, appears poised to lag demand through the near term. Prologis Research forecasts 225 million square feet of net absorption in 2016, tempering to 200 million square feet in 2017. On the supply side, deliveries are expected to total 185 million square feet in 2016, rising to 215 million square feet in 2017. In this scenario, vacancies would remain at their current historically low level, allowing for further rent growth in excess of inflation.

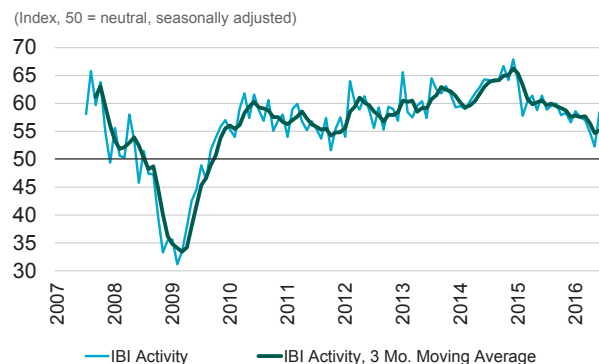
Logistics real estate occupiers are positioning supply chains for the future. Revisiting estimates from about a year ago, we expected net absorption of 175 to 200 million square feet between the third quarter of 2015 and the second quarter of 2016 based on the prevailing temperature of economic growth. In actuality, the market achieved 256 million square feet of net absorption during this period, a strong result, while real GDP growth hovered in the 2% range.² Ultimately, continual outperformance suggests that occupiers of logistics space

are reconfiguring supply chains to account for growth in excess of lackluster near-term economic growth, and are adjusting for major structural trends such as the shift to e-commerce.

Customer activity levels rebounded strongly in June, propelled by strong sales and increased inventory rebuilding. Our survey was conducted in the week after the UK's EU referendum. The vote to leave had no noticeable impact on our results. In fact, the June result was up noticeably from the May result. The June IBI activity reading came in at 57.8, adjusted for seasonality (see Exhibit 1), with a three-month moving average of 55.2. This level reflects normal growth consistent with annual net absorption in the 200 million square foot range (see Exhibit 2).³ Several economic and consumption-related indicators also firmed in recent months, such as job creation, retail sales, consumer confidence and business sentiment.⁴

Occupiers are using most of their leased space, driving demand for logistics real estate. The utilization rate climbed to 86.3% in June, near the all-time high of 86.7% reached in December 2015 (see Exhibit 3). Ultimately, we expect the utilization rate to decrease as customers expand into new space. However, with

EXHIBIT 1: IBI – Activity Index, U.S.

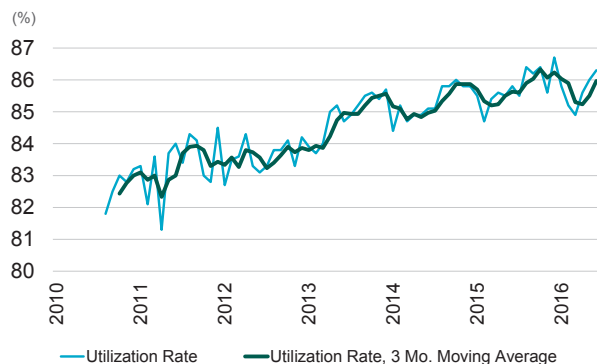


Source: Prologis Research

EXHIBIT 2: Summary of Net Absorption Indicators

| | Latest Reading | as of | Est. Net Absorption (M, sf) | | Regression Fit (R-sqr) |
|---|----------------|-----------------|-----------------------------|------------|------------------------|
| | | | Quarterly | Annualized | |
| IBI-Activity | 55.2 | Jun 2016 | 48 | 194 | 0.86 |
| Weighted Average of Econ Variables | | | 56 | 223 | |
| PMI (non-mfg) | 55.0 | Jun 2016 | 55 | 220 | 0.80 |
| Jobs (private) | 135 | Jun 2016 | 55 | 222 | 0.78 |
| Core Retail Sales | 3.8% | May 2016 | 51 | 205 | 0.71 |
| Inventories | 72.0 | 1Q 2016 | 61 | 244 | 0.72 |

Source: Institute for Supply Management, Bureau of Economic Analysis, U.S. Census, Bureau of Labor Statistics, Prologis Research

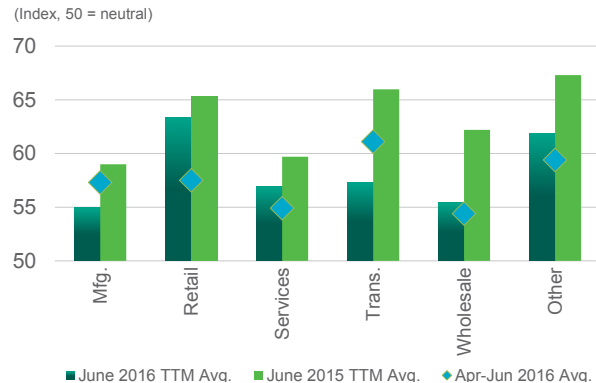
EXHIBIT 3: IBI – Utilization Rate, U.S.

Source: Prologis Research

utilization rates at a high level, it is unlikely that customers are expanding significantly beyond their storage and distribution needs. Because customers have limited existing capacity, they will need to expand into new or larger facilities in order to accommodate more activity.

All industries reported growth in activity, with retail leading and services lagging. In June, IBI activity readings ranged from 54 for services industry customers to 68 for retail. Readings above 50 indicate growth, with readings in the high-50s representing normal growth consistent with the need for new space. While all industries reported growth below year-ago levels (which were unsustainably high), 12-month trailing activity levels have held up best for retail and transportation customers (see Exhibit 4). Notably, manufacturing industry customers have reported significant improvement in activity levels during the past six months.

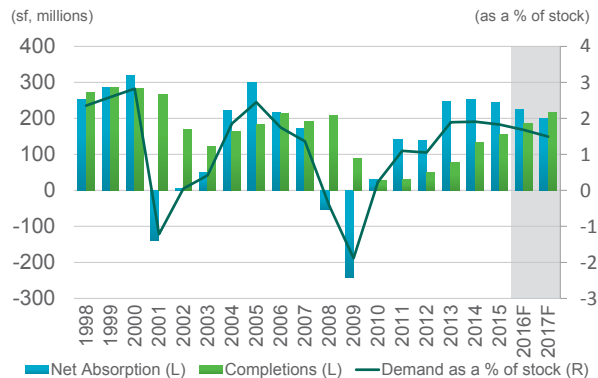
Cyclical and structural factors are poised to drive logistics real estate demand. In spite of volatile financial markets, the current economic environment still presents opportunity for the average American household and, in turn, for increasing consumption that forms the foundation of logistics real estate demand. Healthy job creation and a tight labor market are propelling wage growth, particularly after adjusting for the changing composition of the

EXHIBIT 4: IBI - Activity Index by Industry

Source: Prologis Research

labor force (retiring high-earning baby boomers replaced by early-career Millennials).⁵ Household financial obligations and interest rates remain at historically low levels, while banks gradually loosen lending requirements.⁶ On the structural side, investment in and implementation of dedicated e-commerce supply chains is still in the early stages. With e-commerce occupiers using up to 3x as much distribution space as a typical brick-and-mortar retailer, this trend should provide tailwinds to logistics real estate demand for years to come.

Prologis Research has revised our forecast up for 2016 demand. Building on the strength of year-to-date net absorption and a positive outlook for demand, Prologis Research increased our projection to 225 million square feet of net absorption in 2016 (see Exhibit 5). Looking further ahead, the demand outperformance of recent years should moderate to normal demand in line with the pace of economic growth. Prologis Research expects 200 million square feet of net absorption in 2017. At the same time, structural factors limiting development should lead to another year of a supply deficit with only 185 million square feet of completions expected in 2016. The continued strength of market conditions and the consequent rising rental rates should attract more development, with forecasted completions totaling 215 million square feet in 2017. Ultimately, this relative supply-demand balance should hold the vacancy rate steady at a historically low level of 5.2% through the near term. This vacancy level should present a continued challenge for real estate occupiers, and the importance of advance planning for requirements will not fade in the foreseeable future. A sustained landlords' market should put upward pressure on rental rates, allowing for robust NOI growth as leases roll.

EXHIBIT 5: Operating Fundamentals, U.S.

Source: CBRE-EA (history), Prologis Research (forecast)

ENDNOTES

1. CBRE-EA. Note: data provider adjusted their methodology, which translated to a downward change in vacancy rates. Therefore, vacancy rate figures in this report are not comparable to prior reports.
2. U.S. Bureau of Economic Analysis
3. Based upon 15-year regression analyses, with data when available, using an auto-regressive process. IBI and PMI are the three-month moving average index levels. Jobs series is the three-month moving average change for private sector employment in thousands. Core retail sales (ex. autos and gasoline) are yr/yr growth in the three-month moving average. Private inventories change is quarterly in billions of 2009 dollars. The weighted average is based on R-squareds.
4. U.S. Bureau of Labor Statistics, U.S. Census Bureau, University of Michigan, Institute for Supply Management
5. U.S. Bureau of Labor Statistics, U.S. Census Bureau
6. U.S. Federal Reserve

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Prologis' research department studies fundamental and investment trends and Prologis' customers' needs to assist in identifying opportunities and avoiding risk across four continents. The team contributes to investment decisions and long-term strategic initiatives, in addition to publishing white papers and other research reports. Prologis publishes research on the market dynamics impacting Prologis' customers' businesses, including global supply chain issues and developments in the logistics and real estate industries. Prologis' dedicated research team works collaboratively with all company departments to help guide Prologis' market entry, expansion, acquisition and development strategies.

ABOUT PROLOGIS

Prologis, Inc. is the global leader in logistics real estate with a focus on high-barrier, high-growth markets. As of March 31, 2016, the company owned or had investments in, on a wholly owned basis or through co-investment ventures, properties and development projects expected to total approximately 667 million square feet (62 million square meters) in 20 countries. Prologis leases modern distribution facilities to a diverse base of approximately 5,200 customers across two major categories: business-to-business and retail/online fulfillment.