3Q 2024

BKM Capital Partners

Multi-Tenant Light Industrial

MAINTAINING RESILIENCE IN TURBULENT ECONOMIES

BKM INTEL | THOUGHT LEADERSHIP SERIES

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EXECUTIVE SUMMARY

Multi-tenant light industrial real estate continues to exhibit compelling fundamentals. The sector has demonstrated remarkable resiliency during major economic disruptions, including the Global Financial Crisis (GFC) in 2008, the depths of the COVID-19 pandemic in 2020, and the rapid interest rate hikes from March 2022 to July 2023.

In 2023, broader industrial fundamentals experienced a slight deceleration, primarily due to factors such as a wave of new deliveries, tenant demand normalization, extended inflationary periods, elevated financing costs, and global economic uncertainties.

Despite these challenges, optimism remains high for multi-tenant light industrial properties due to their innate, fundamental advantages and secular tailwinds. Favorable changes in capital markets, including anticipated interest rate cuts in the near future, are expected to further enhance the sector's performance.

BKM's decade-long track record of top-quartile performance, coupled with its niche market expertise surrounding the small-bay light industrial sector, yields high credibility for analyzing current market dynamics and forecasting future sector performance.

Looking ahead, we see significant opportunities for strong risk-adjusted returns through investing in well-located submarkets with high barriers to entry and robust tenant demand. These factors, combined with our vertically integrated operator platform, consistently produce top quartile returns for our investors.

This whitepaper will explore BKM's established expertise in the multi-tenant light industrial sector and examine how this property type and its diverse tenant base perform in recessionary economic environments.

ECONOMIC COMMENTARY

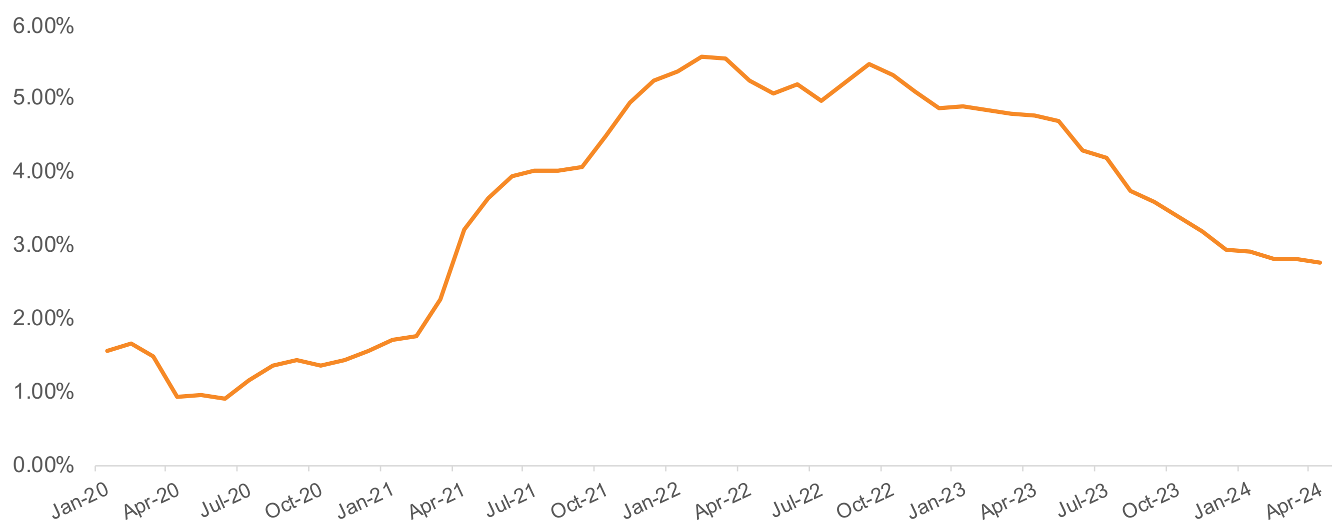
Tempered Inflation

In June 2024, the Consumer Price Index (CPI) decreased by 0.1% from the previous month, bringing the 12-month rate to 3%. This is the lowest level in over three years and significantly below the peak of 9.1% recorded in June 2023, which was the highest in more than 40 years.

Since reaching its peak of an annualized 5.57% in February 2022, the Core Personal Consumption Expenditures (PCE) prices, which exclude volatile food and energy costs, fell to 2.75% YOY in April 2024, below the average of 3.4% over the 12-month period from May 2023 to April 2024.[1] This observation is an early indication of softening inflationary pressure, easing the financial strain on consumers and businesses who have coped with highly elevated costs in recent quarters.

Fortunately, data on expectations suggest that the Federal Open Market Committee's (FOMC's) inflation-fighting credibility remains intact. For capital market participants, inflation continues to be an area of focus as the Fed remains committed to returning inflation to the target of 2.0%.

Core PCE



Source: Federal Reserve Bank of St. Louis.

Contractionary Monetary Policy

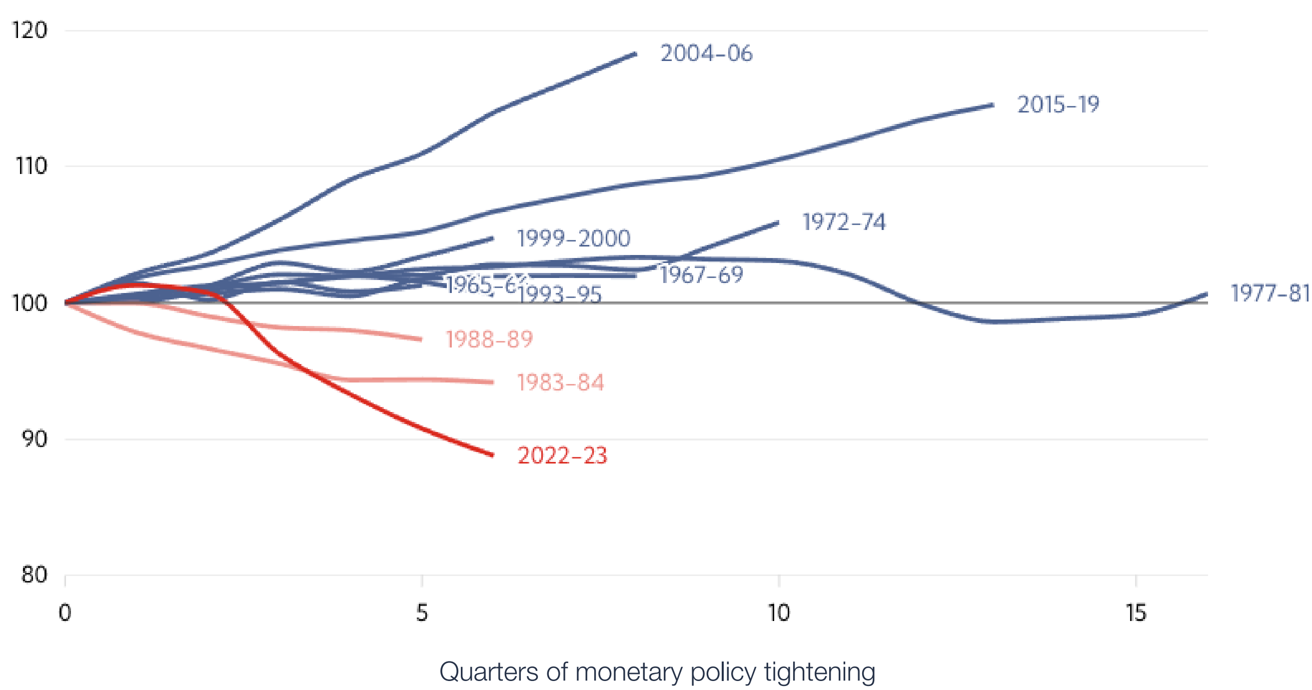
As recently as the first quarter of 2022, the FOMC maintained the federal funds rate near zero and continued purchasing billions of dollars in bonds each month to stimulate the economy, all despite 40-year highs in various measures of U.S. inflation.

To combat inflation, the FOMC initiated a rapid series of rate hikes in March 2022, increasing the federal funds rate from 0.25%- 0.50% to 5.25%- 5.50% by July 2023.

This action had a significant impact on the commercial real estate (CRE) market, affecting both sales and leasing activities. The higher cost of capital reduced liquidity in capital markets, complicating transaction financing and stressing existing loan covenants, leading many to negotiate modifications, face foreclosures, or initiate fire sales. Additionally, landlords faced increased operating costs, necessitating rental hikes and thereby slowing leasing activity and valuation growth. Despite these significant rent increases, tenants have remained in place because warehousing costs constitute only a small fraction of their total overhead (3-5%), insulating this property type from a mass exodus to cheaper alternatives.[2]

Compared to previous monetary policy tightening cycles, this rate hike series has resulted in some of the historically lowest sector pricing and a noticeable slowdown in private equity fundraising.

U.S. Real Commercial Real Estate Prices During Monetary Policy Tightening Cycles, Index



Sources: BIS, MSCI, and authors' calculations. Note: Price in the first quarter of the cycle=100. Dates for past US monetary policy tightening cycles are from A. Blinder, 2023, Journal of Economic Perspectives, 37(1). The current tightening cycle is dated as 2022Q1-2023Q3.

It is worth noting that industrial sale prices have continued to increase during this time, outpacing opposing factors such as a decline in transaction volume, a wave of new supply entering the market, and an elevated cost of capital. Valuations have also continued to rise as they catch up to the rapid rent growth experienced in the last three years.

By May 2024, the average industrial sale price across the country reached $142 per square foot, up 15.4% year-over-year and 71.2% higher than in 2019.[3]

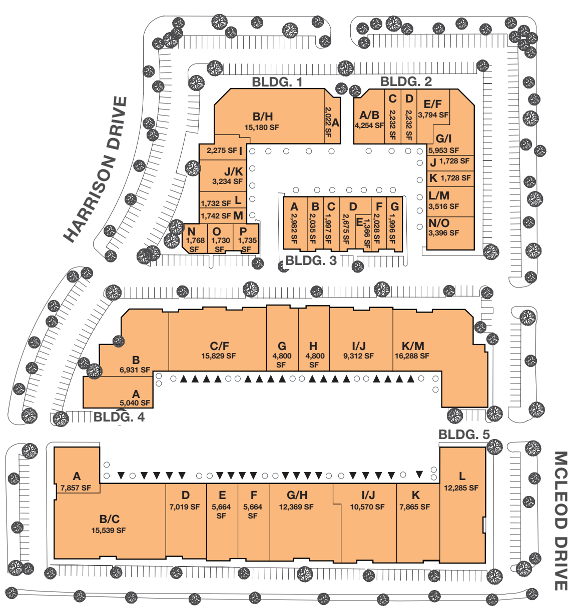
The national average rate for all in-place leases at this time was also $8.00 per square foot, a 7.5% increase over the past twelve months. New leases signed in the last year averaged $10.25 per square foot, with premiums for new leases significantly higher in the most sought after markets.[3]

DEFINING THE SECTOR

What is Multi-Tenant Light Industrial?

Multi-tenant light industrial is an important yet typically overlooked sub-sector of industrial real estate, with leases under 250,000 square feet representing the majority of all leasing activity in the industrial asset class. Given the number of tenants in a typical multi-tenant light industrial business park, these assets tend to be operationally intensive and require a strong local market presence, asset management expertise, and scalable technology.

Site Plan Example



LIGHT INDUSTRIAL FUNDAMENTALS

- Properties less than 200,000 SF, spaces under 50,000 SF
- ~80% industrial, ~20% office buildout
- Typically found in infill locations with close proximity to city centers
- 20-200 units, typically housing manufacturing, distribution, and e-commerce tenants
- Typical WALT of 1-3 years

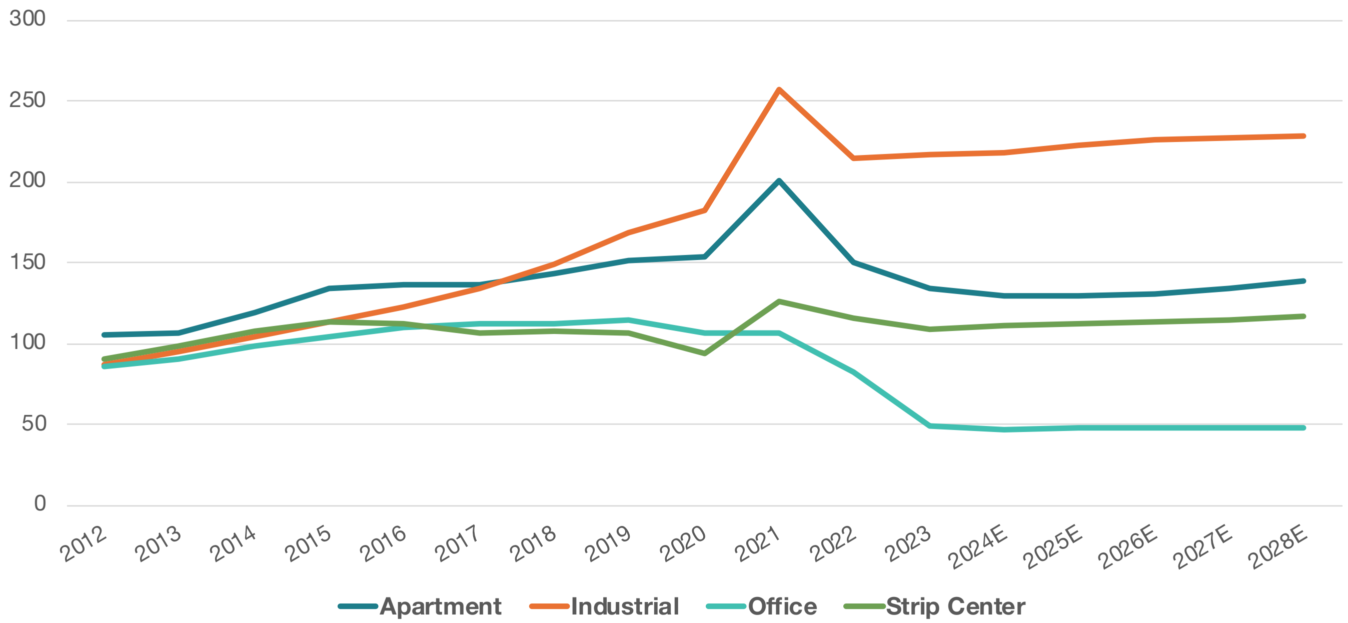
HISTORICAL SECTOR PERFORMANCE

Resiliency During Times of Economic Weakness and Uncertainty

During periods of significant economic uncertainty such as the Great Financial Crisis (GFC), the COVID-19 pandemic, and the recent rapid interest rate hikes, multi-tenant light industrial properties have demonstrated remarkable resiliency and stability. Occupancy and rent collections within the sector remained stable, resulting in exceptional risk-adjusted returns for investors over the following periods despite varying capital market environments.

According to Green Street's Commercial Property Price Index (CPPI), industrial properties have appreciated the most since 2015 compared to apartments, office, and retail. The asset class has also shown the greatest price elevations following these major economic events.

Commercial Property Price Index (CPPI)



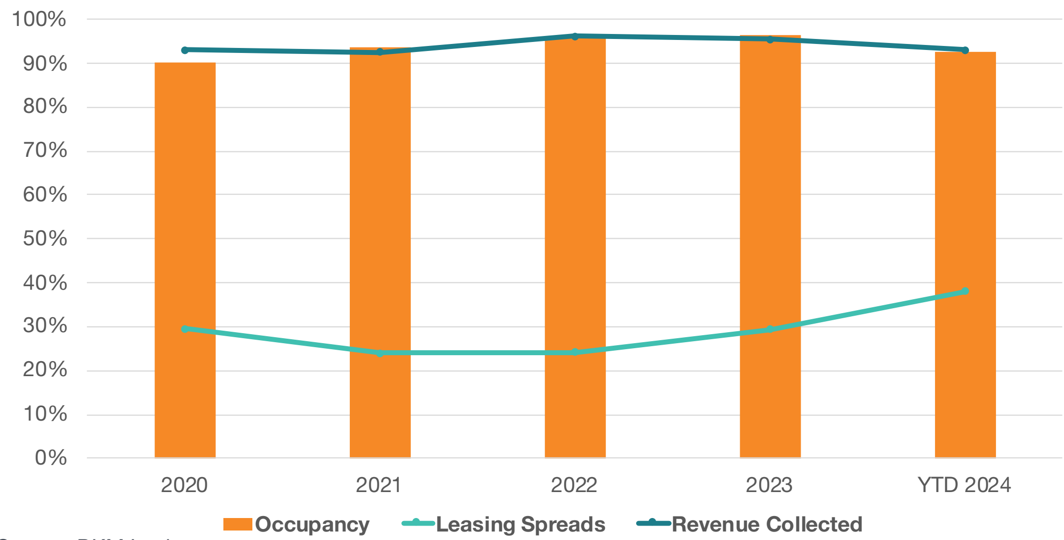
Source: Green Street Advisors as of Q1 2024. Base index of 100 in 3Q 2007.

BKM Historical Portfolio Performance

BKM's multi-tenant light industrial portfolio has exhibited impressive performance including strong leasing spreads, minimal credit loss, and high occupancy rates since the firm's inception in 2013. As of Q2 2024, BKM's portfolio of approximately 10 million square feet has continued to outperform even during the COVID-19 pandemic and subsequent interest rate hikes, all despite a global shutdown and Core PCE peaking at 5.57%.

This observed resiliency underscores the consistent, competitive tenant demand for light industrial space, particularly for properties like those offered by BKM that include upgraded amenities and high-end, functional unit designs.

Occupancy and Revenue Performance



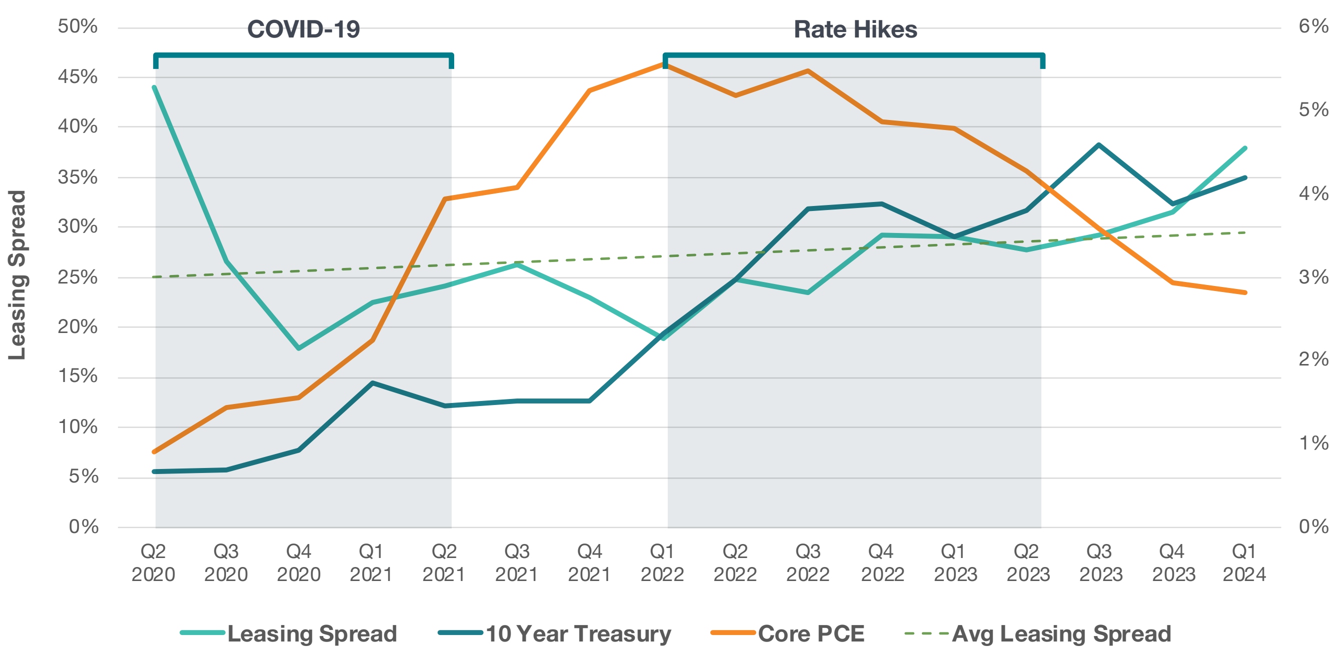
29% Avg. Leasing Spreads

93% Avg. Portfolio Occupancy

94% Avg. Revenue Collections

Source: BKM Intel.

Leasing Performance

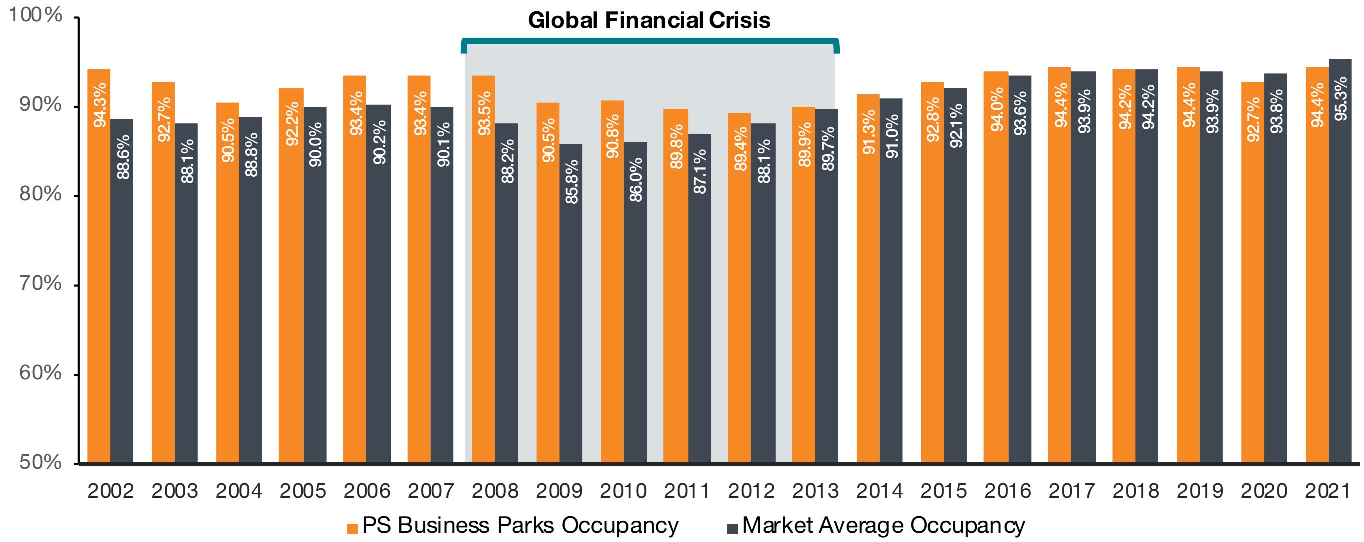


Source: BKM Intel, Federal Reserve Economic Bank of St. Louis.

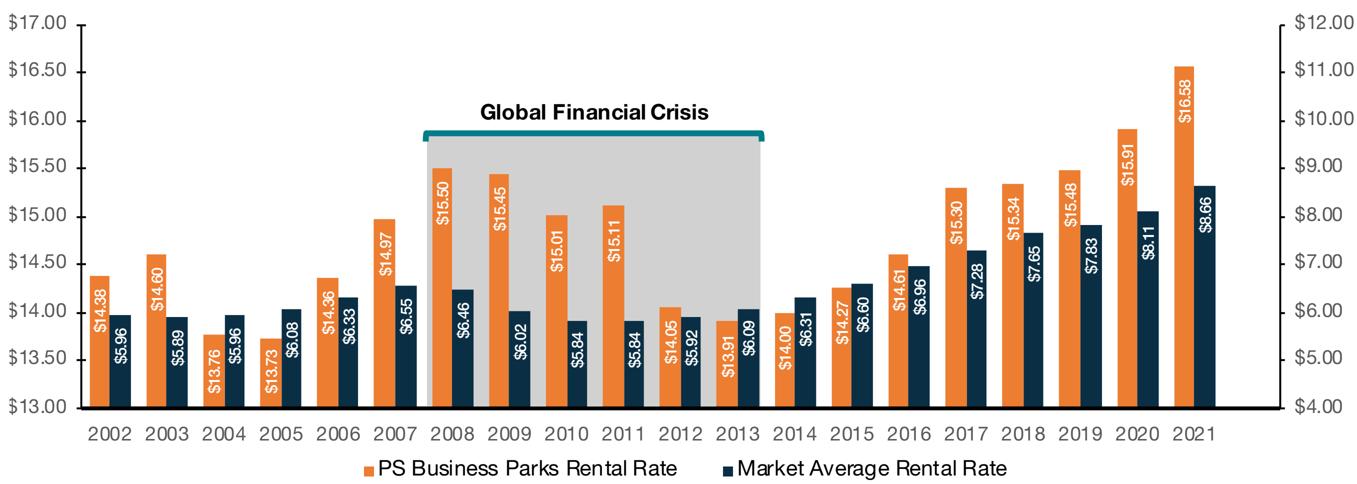
Multi-Tenant Light Industrial Performance During the Global Financing Crisis

PS Business Parks, acquired by Blackstone and formerly the largest public REIT focused on the multi-tenant light industrial sector, represents an excellent case study for evaluating the performance of the multi-tenant light industrial asset class over time. During the GFC, PS Business Parks significantly outperformed the broader market in terms of rent and occupancy as seen below:

Average Occupancy



Average Rents



Source: PS Business Parks.

Note: Market average occupancy and rental rates sourced from CBRE, CoStar Group & Moody's Economy.com and represent single and multi-tenant buildings less than 120,000 SF across the U.S. PS Business Parks data comprises a mix of industrial, flex, and office space.

In 2010, PS Business Parks' vacancy rate of 9.2% was 48% lower than the average market vacancy rate of 13.7%. Additionally, during the GFC recessionary period, market rental rates experienced a 15.0% drop, while PS Business Parks saw less than a 10% drop in rates. This outperformance was a result of PS Business Parks' diversified tenant base, vertically integrated platform, and short-term lease structures.

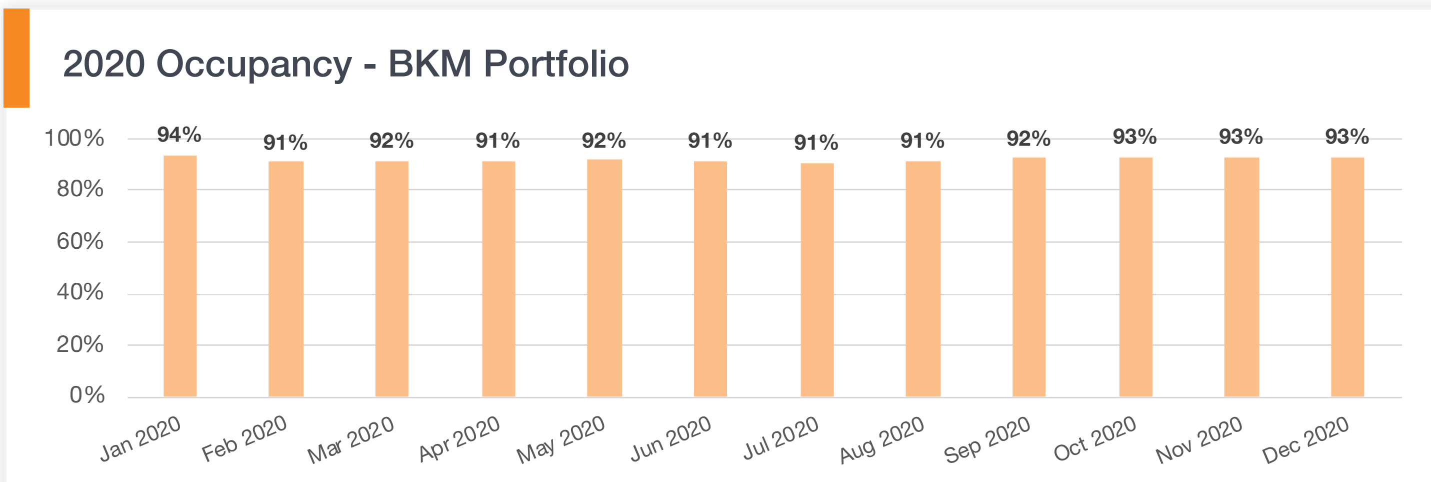
Multi-Tenant Light Industrial Performance During the COVID-19 Pandemic

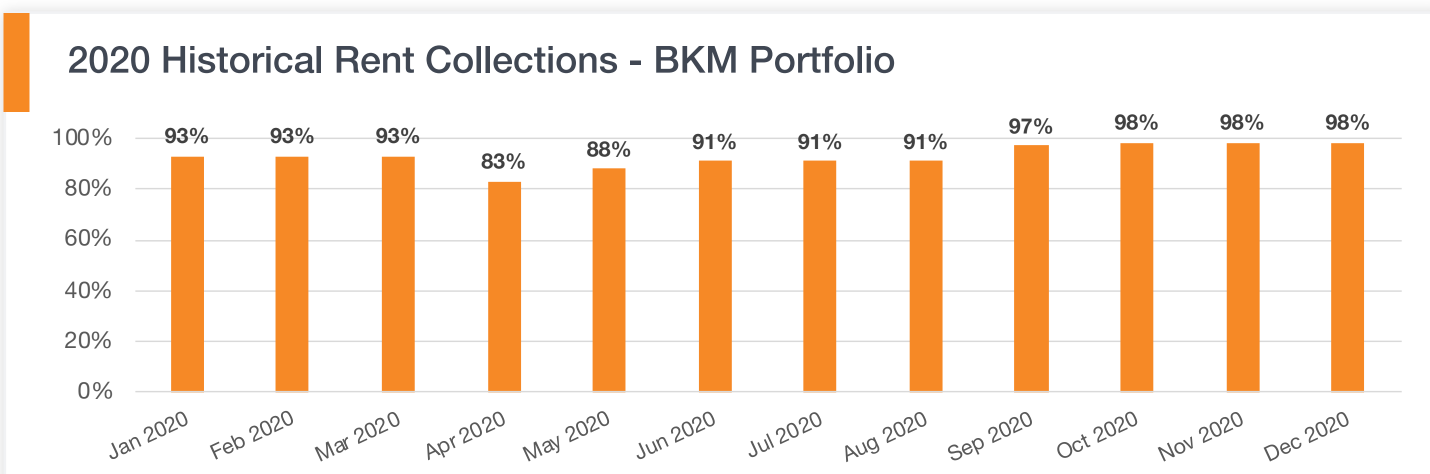
While the COVID-19 pandemic created challenges for real estate owners across the country, BKM's portfolio continued to perform as the firm took advantage of attractive market opportunities, transacting heavily through what was a tough lending environment for many.

Multi-tenant light industrial real estate is mission critical, with many of the small businesses representing an extension of the owner's livelihoods and relying on a single location, all of which contributed to BKM's strong portfolio performance during COVID-19. A key reason for this success was also due to BKM's vertically integrated platform including in-house asset management, construction, leasing, and on-site property management functions. The ability to be in close contact with tenants and address issues before they escalated proved to be a valuable advantage during the depths of the pandemic. BKM worked together with tenants, many of whom are small businesses, to provide rent assistance and resources through government programs, community support, and/or direct rent relief.

If a tenant needed to expand or change suites, BKM's in-house teams were ready to mobilize. BKM's construction team proactively built-out vacant space with flexible space configurations, making it possible for tenants to tour a space and begin operations merely days after signing a lease.

BKM avoided huge swings in occupancy and rent collections throughout the COVID-19 pandemic due to the staggered rollover of short-term leases, further aiding in BKM's negotiating power.



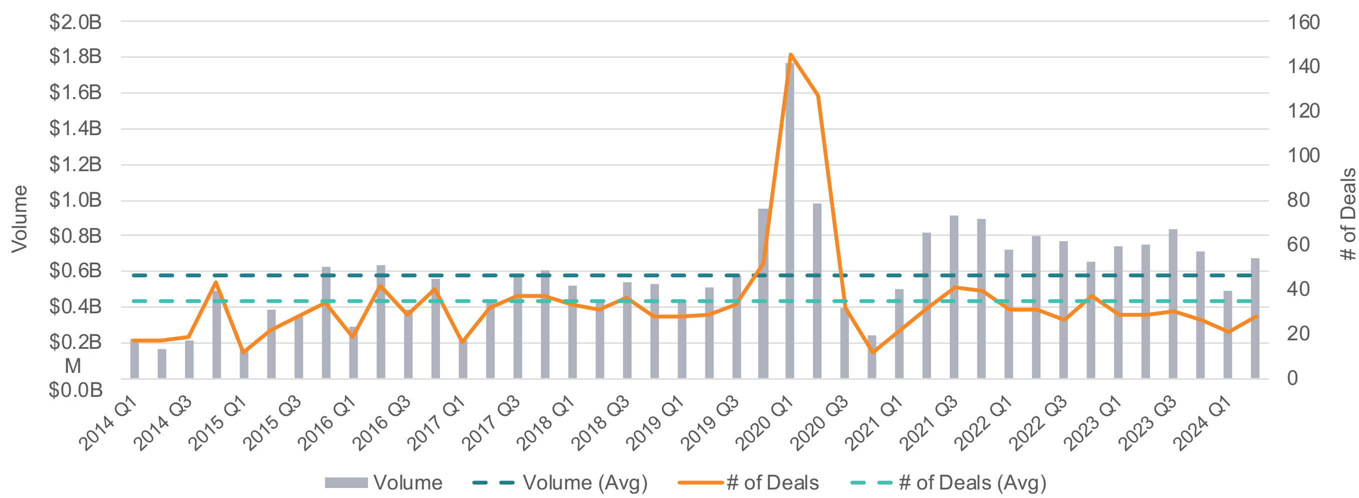


Multi-Tenant Light Industrial Performance During the Rapid Interest Rate Hikes in 2022

Against the backdrop of persistent inflationary concerns, multi-tenant light industrial properties have continued to demonstrate remarkable resiliency and stability. Even as transaction volume dipped across the sector, lenders found favorability in the light industrial asset class, which benefits from a diverse tenant mix and strong supply/demand fundamentals.

Recent activity through 2024 has shown the light industrial sector's continued transaction volume rising above the 10-year average of $600 million, exemplifying a "return to normal" post-pandemic. While the cost of capital is relatively high upfront prior to execution of business plan, outsized returns are achieved through a successful value-add program which allows for return characteristics to remain strong even in the face of today's dynamic economy.

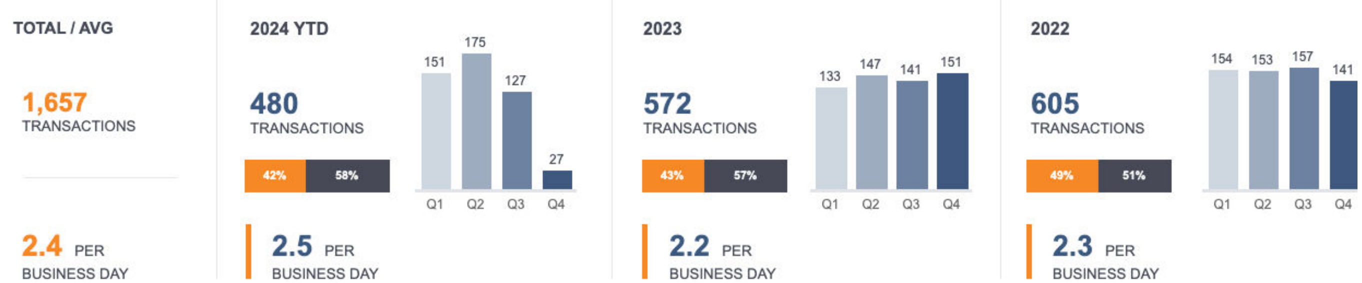
Light Industrial Liquidity



Source: BKM Intel

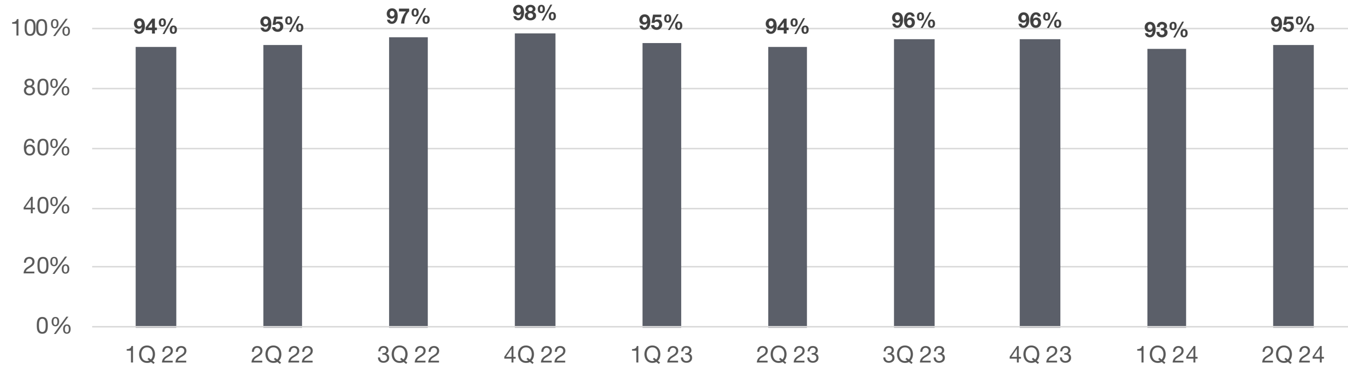
Despite growing economic concerns, tenant demand in the light industrial sector has remained steady throughout the rate hikes, leading to sustained leasing activity and continued operational performance within the BKM portfolio.

BKM Leasing Transaction Volume

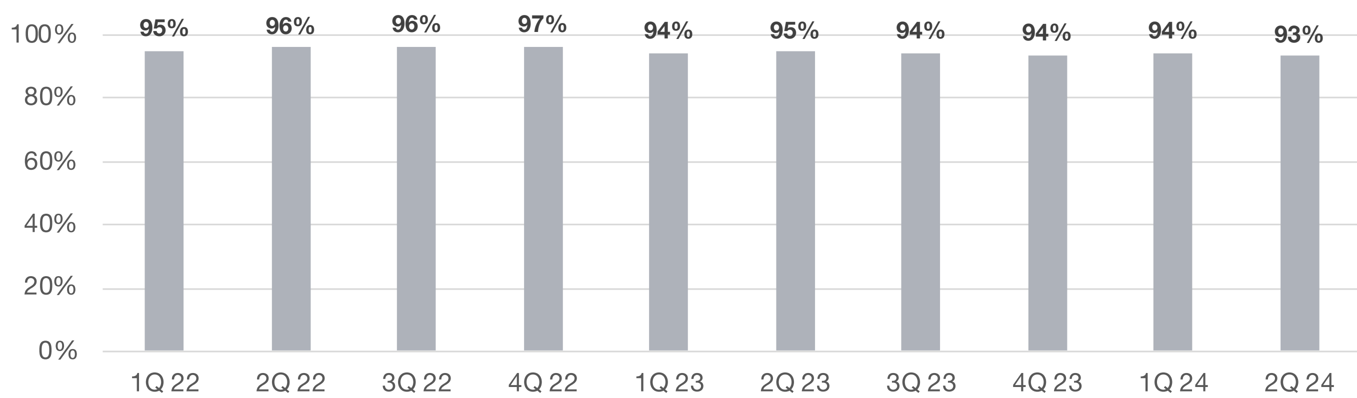


Occupancy and rent collections within the sector have also remained stable, resulting in exceptional risk-adjusted returns for investors over this period despite varying capital market environments.

Rent Collections During Rate Hikes - BKM Portfolio



Occupancy During Rate Hikes - BKM Portfolio



ASSET CLASS FUNDAMENTALS

Multi-tenant light industrial has emerged as one of the latest darlings in real estate. In contrast to bulk industrial with long-term leases, which behave like fixed income investments, investors are drawn to multi-tenant light industrial for two primary reasons:

1) Strong supply and demand fundamentals

2) Short-term structural aspects of the leases

With persistently high inflation and rising interest rates, investors have sought out properties with shorter term leases and robust fundamentals to mark-to-market rents more frequently. Inherent in the multi-tenant light industrial sector are the following property attributes that institutional investors find attractive:

1	**Secular Demand Tailwinds**
2	**Limited Inventory and High Barriers to Entry**
3	**Historically High Occupancy and Strong Rent Growth**
4	**Downside Protection from Infill Locations**
5	**Inflation Protection Derived from Short-Term Leases**
6	**Highly Diversified Rent Rolls**
7	**Historically Low Credit Losses**
8	**Institutional Management Yields Downside Risk Protection**

Secular Demand Tailwinds

Tenant demand for the light industrial asset class has been bolstered by many secular demand tailwinds that are expected to continue for the foreseeable future.

1 E-Commerce

The growth of e-commerce has significantly impacted supply chain logistics, driving increased demand for distribution centers, warehouses, and fulfillment facilities near urban centers and major transportation hubs. Essential for efficient order fulfillment and timely delivery, these properties are now more critical than ever. Additionally, the shift towards e-commerce has spurred the need for larger storage spaces and advanced infrastructure, further boosting demand for industrial real estate.

» E-Commerce is expected to grow at a **6.7% CAGR** over the next few years, leading to a continued surge in industrial demand.[4]
» To support every additional $1.0 billion in e-commerce sales, approximately **1.2 million square feet of logistics space** will be required.[4]
» E-Commerce remains a critical source of logistics demand and is expected to represent **~25% of net absorption** over the next five years on average.[5]

2 Manufacturing and Onshoring

Flexible zoning and functionality are essential to accommodate various uses, including assembly, warehouse, and manufacturing. Onshoring, especially in EV and semiconductor production, has gained momentum in the U.S. due to government incentives like the CHIPS Act and the Inflation Reduction Act. The disruption of global supply chains by COVID has highlighted the importance of a local manufacturing and distribution network, prompting companies to diversify product sources, protect intellectual capital, and leverage government incentive programs.

» The U.S. manufacturing base spans approximately **7 billion square feet** nationwide.[6]
» In real spending, manufacturing construction measured **$115.6 billion** in March 2024, nearly double the pre-pandemic 5-year average.[7]
» Goldman Sachs analysts reported that every $1 million increase in manufacturing construction spending leads to roughly nine new manufacturing jobs. With $65 billion in spending expected over the next two years, that amounts to over **half a million new jobs.**
» **The Multiplier Effect:** For every direct manufacturing job, **eight indirect jobs** are created within the economy as a result (i.e., 9.0x job multiplier), far outpacing many other industries.[8]

3 Supply Chain Reconfiguration

The global supply chain has transformed in recent years due to technological advancements, geopolitical shifts, and evolving consumer demands. Now more than ever, logistics and inventory management are at the forefront of business decisions, keeping pace with the hyper-competitive economy that demands constant innovation and technological advancement. This increased desire for efficiency requires a logistics network as least exposed to risk as possible, meaning onshore manufacturing and local distribution are essential for businesses to stay ahead in the competition.

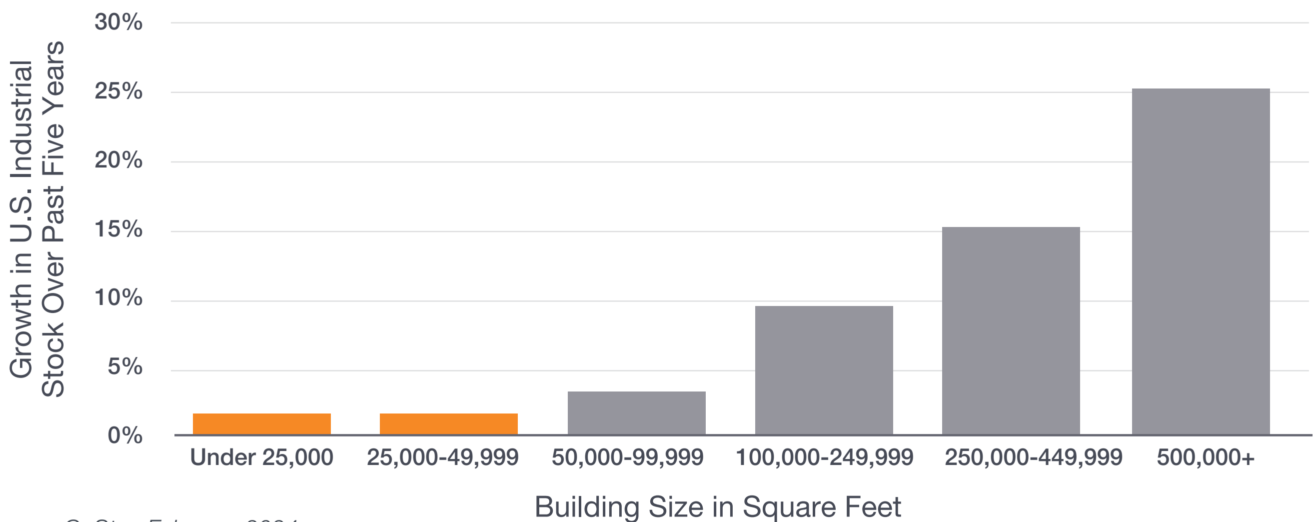
Limited Inventory and High Barriers to Entry

Historically, over-supply has been one of the catalysts for real estate recessions. Despite this, available space for smaller industrial properties remains near record low levels, as fewer developers are building properties that can accommodate smaller tenants. For example, industrial properties smaller than 25,000 square feet comprise 29% of existing U.S. industrial space, but less than 2% of the industrial space under construction in 2024. These figures stand even lower in BKM's target markets, resulting from high barriers to entry and soaring construction costs that significantly hinder development.

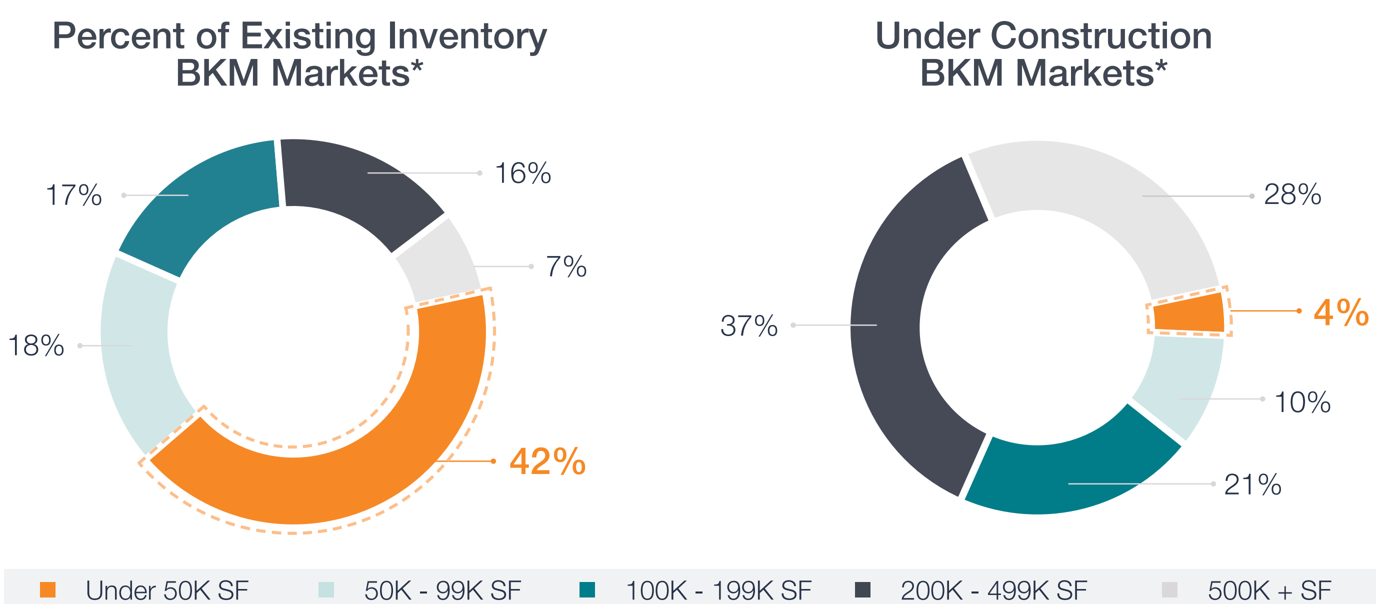
The stock of industrial properties measuring smaller than 100,000 square feet has only grown by about 2% cumulatively over the past five years, while growth in the stock of industrial properties sized 100,000 square feet or larger has grown eight times as quickly, by about 16%.

Growth in U.S. Industrial Stock: Past Five Years

Industrial development focused on larger properties



Source: CoStar, February 2024.



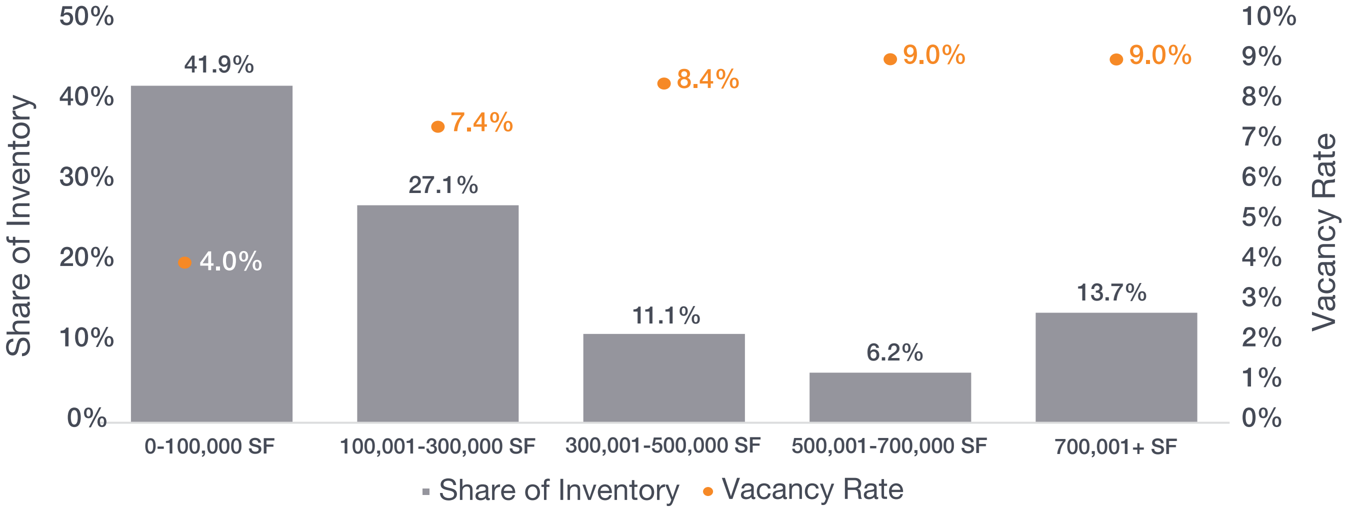
Source: CoStar as of July 2024. Represents markets BKM is actively investing in.

Historically High Occupancy and Strong Rent Growth

Multi-tenant light industrial assets have experienced exceptional rent growth patterns in past quarters as their function in the global supply chain has come clearer into view. This, coupled with the sector's withstanding supply and demand dynamics have positioned this asset class for sustained future growth. These assets also possess innate competitive advantages that allow the product type to maintain occupancy and grow revenue.

Industrial properties under 100,000 square feet represent the largest portion of Industrial inventory and the tightest vacancy rate. Surging tenant demand and lack of new supply will only bolster this healthy market fundamental paradigm.

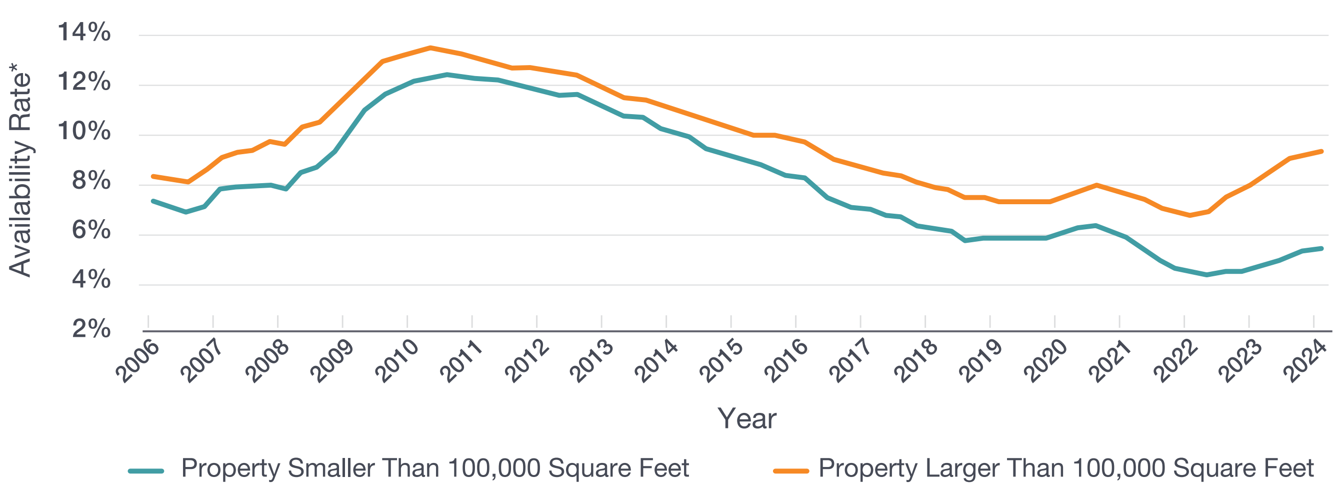
1Q24 Industrial Vacancy Rate by Building Size



Source: CoStar, Newmark Research, April 2024.

With few small industrial developments being built, the national vacancy rate for these properties remains below 4% and near the lowest levels ever recorded before the pandemic.[9]

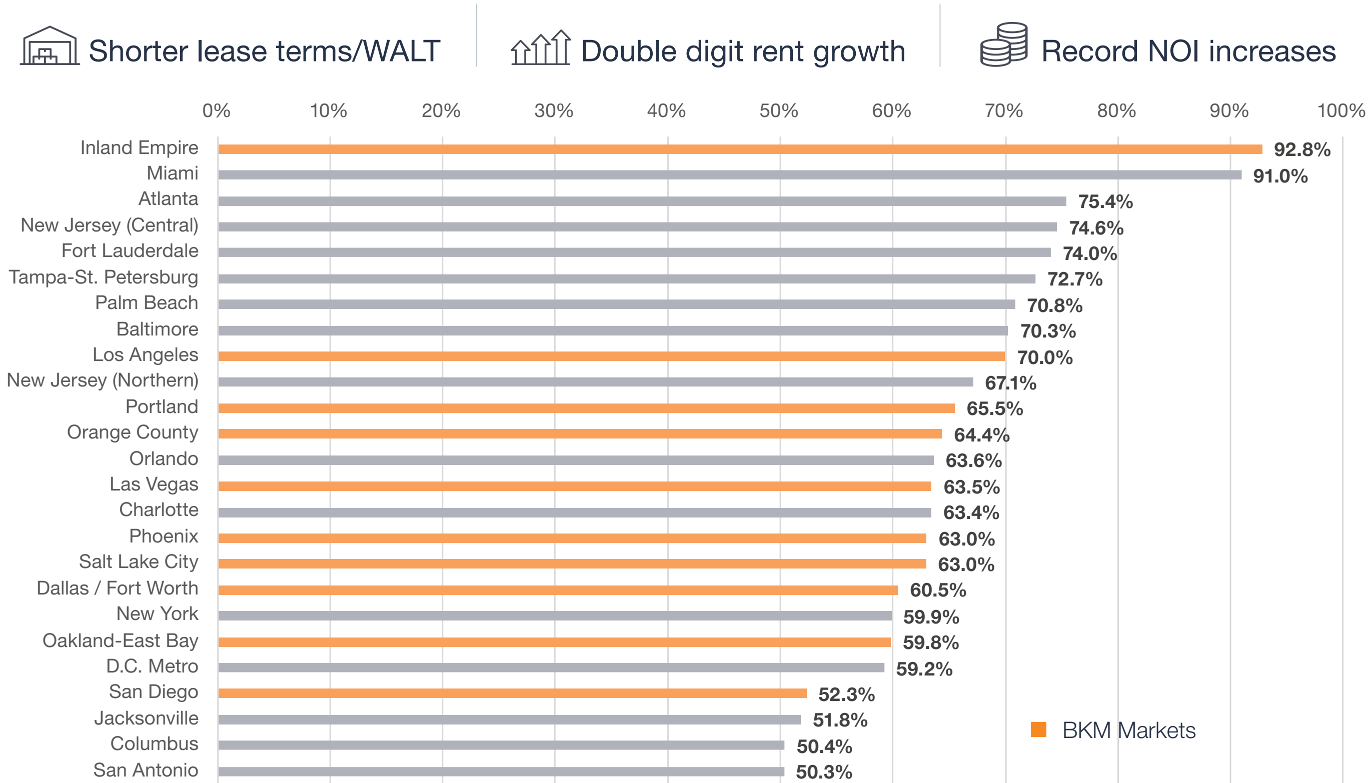
Development Wave Lifts Availability of Larger Properties



*Source: CoStar, February 2024. *Includes existing and under construction U.S. industrial space.*

Recent exponential rent growth in small bay light industrial properties has been driven by surging demand for e-commerce and last-mile logistics, coupled with limited supply. This trend is expected to continue at a more moderate pace as supply constraints and strong tenant demand persist.

2021-2023 Cumulative Industrial Rent Growth - Top 25 MSAs



As of Green Street's Q4 2023 M-RevPAF forecast. The M-RevPAF growth combines changes in effective rents and occupancies into a single measure.

Downside Protection from Infill Locations

Decades ago, many of today's existing multi-tenant light industrial buildings were constructed on the periphery of large urban populations. With the drastic acceleration in urbanization over recent decades, many of these assets are now engulfed by population centers, making them ideal candidates for infill supply-chain networks.

Given the limited availability of land and high barriers to entry in infill markets, we've noticed the "Multiplier Effect" trend accelerate. This is a trend whereby secondary markets benefit from the construction of large distribution centers and advanced manufacturing facilities, which drives growth and demand from downstream companies servicing these hubs, creating jobs, population growth, and strong real estate fundamentals.

Inflation Protection Derived from Short-Term Leases

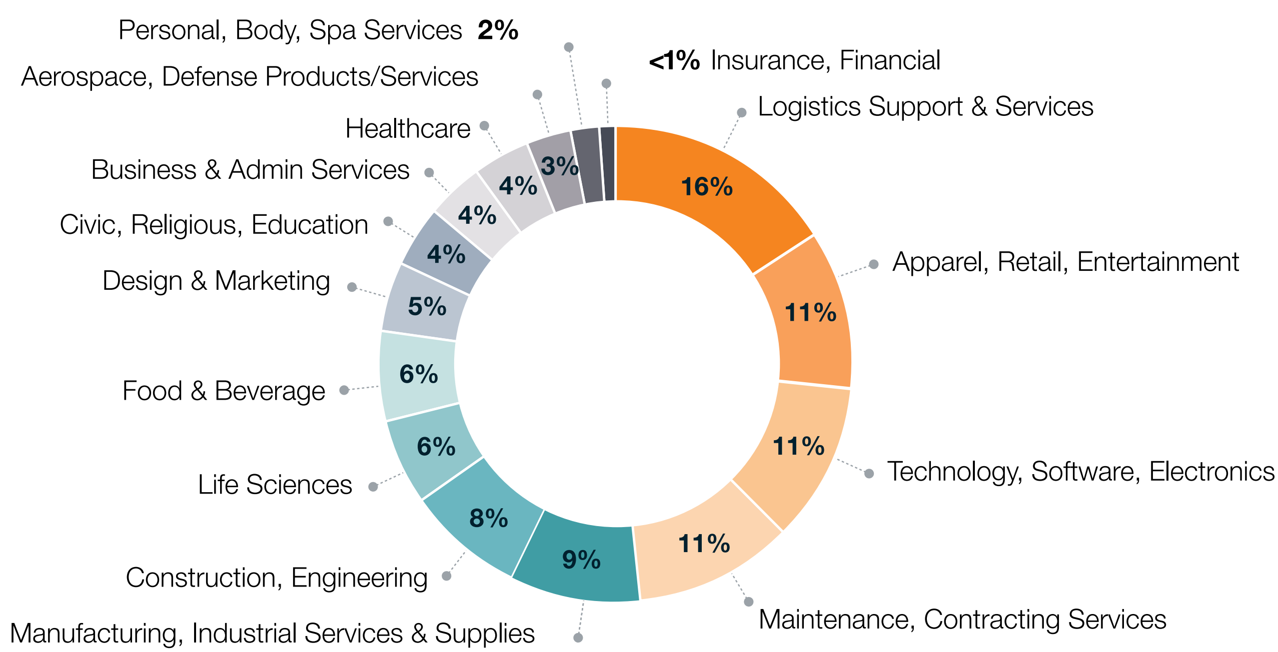
In an inflationary environment, multi-tenant light industrial's shorter duration leases are advantageous given the ability to mark-to-market rents more rapidly, thus acting as a natural inflation hedge. BKM's portfolio has a WALT (weighted average lease term) of 2.4 years, allowing for the capture of higher rents as leases come up for renewal or roll-to-market. When compared to the typical bulk industrial lease with a WALT of 10 years, the result is a more valuable revenue stream due to greater cumulative revenue capture over time, all else equal.

Highly Diversified Rent Rolls

Multi-tenant light industrial provides a highly diversified tenant base and rent roll. This diversification minimizes the impact of any one tenant on the overall performance of the property, as well as the impact of downturns in any single sector. During times of heightened uncertainty and volatility, diversification is a widely desired attribute given its downside protection benefits.

This is best exemplified in BKM's portfolio tenant composition noted below, with no exposure greater than 16%:

BKM Portfolio Tenant Breakdown by Industry Sector



Data as of June 30, 2024

57	4,572 SF	1,721	375
Active Properties	Average Suite Size	Tenants	Buildings

Many multi-tenant light industrial tenants operate in essential industries that remain in demand even during economic downturns. Furthermore, multi-tenant light industrial spaces are generally more flexible and can be easily adapted for different uses. This adaptability makes it easier to attract new tenants if existing ones leave, thus maintaining occupancy rates and rental income.

Historically Low Credit Losses

Since 2018, BKM's portfolio has averaged a credit loss of less than 1.0% of revenue. During 2020 in the depths of the COVID-19 pandemic, credit losses only represented 0.3% of revenue, while during 2022 in the midst of rapid interest rate hikes, credit losses represented only 0.6%. Low credit losses are a byproduct of tenant diversification, BKM's vertically integrated platform, and a strong on-site presence at the properties, where potential tenant issues can be circumvented or addressed before they become significant.

Institutional Management Yields Downside Risk Protection

Broadly speaking, active and vertically integrated institutional managers in the multi-tenant light industrial space like BKM have outperformed relative to their peers since the pre-GFC era. The sector has historically been dominated by small private owners, who carry a preference to maintain cash flow via the delay of capital expenditures and a bias towards maintaining occupancy at the expense of achieving market rents. The differentiation provided by sophisticated, institutional on-site management is critical to the performance of multi-tenant light industrial properties and their ability to perform through market cycles along with capturing value through marking rents to market.

FUTURE OUTLOOK

Multi-tenant light industrial has demonstrated remarkable resiliency during major economic events including the Global Financial Crisis (GFC), COVID-19, and the recent interest rate hikes. Numerous key performance indicators attribute the sector's success to its strong fundamentals, allowing sophisticated owners and operators to produce outsized investment returns even in challenging environments.

OPPORTUNITY

Now and over the next 3-5 years is the time to invest in a very inefficient market, created by record breaking rent growth and no new development for the foreseeable future.

» **50% to 90% cumulative historical market rent growth** over the past 36 months, presenting an opportunity to grow NOI.

» **2% cumulative growth** in the stock of small-bay properties in the past five years, further increasing the gap between supply and demand.

» **4% of the construction pipeline represents small-bay properties,** placing increased value on revitalized parks with upgraded amenities and hands-on management.*

» **6.7% growth in e-commerce expected** over the next few years, contributing to greater warehouse demand.

» **Over $300B of new manufacturing facilities currently under construction,** creating a "Halo Effect" of critical vendors performing advanced manufacturing and 3-D printing, all of which require small-bay facilities.

» **38% leasing spreads** achieved across the BKM portfolio in 2024, driven by robust tenant demand.

» **2.5 transactions executed per business day YTD 2024,** indicating continued leasing velocity and tenant appetite for BKM spaces.

We continue to view the future of the light industrial sector optimistically, and should the United States economy continue to experience volatility, historical performance suggests that the sector can be expected to outperform on a relative basis.

**Represents only the markets in which BKM actively invests.*

SOURCES

[1]Federal Reserve Bank of St. Louis Economic Data

[2]CBRE Supply Chain Consulting | September 2023

[3]Commercial Edge | National Industrial Report | June 2024

[4]Newmark | 4Q23 National Industrial Market: Conditions and Trends

[5]U.S. Census Bureau and Green Street | April 2024

[6]Newmark and CoStar | January 2024

[7]Newmark | 4Q23 National Industrial Market: Conditions and Trends

[8]Emsi, Camoin Associates

[9]CoStar | Available Space for Smaller Industrial Properties Remains Near Record Low

ABOUT THE AUTHOR

BKM Capital Partners is a proven real estate fund manager and operator focused exclusively on investing in multi-tenant light industrial and multi-use logistics properties in the Western United States. Headquartered in Newport Beach, CA, with over 90 employees in 13 offices, BKM Capital Partners implements a value-add strategy targeting under-managed and under-capitalized assets. The team has invested over $3.6 billion in over 100 small and mid-bay light industrial properties since 2013. Its approach includes the acquisition, refurbishment, repositioning, and active management of these industrial properties to drive NOI growth and generate a strong IRR and multiple on invested equity. BKM's foundation is built upon Focus, Operational Excellence, Technology, and Client Service.

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