

Kayne Anderson

Complexity meets opportunity in light industrial

Chase McWhorter, Institutional Real Estate, Inc.'s Managing Director, Americas, spoke in January with Kayne Anderson's **Nishant Bakaya**, Senior Managing Director, Investments, Real Estate and **Brian Lessans**, Managing Director, Investments, Real Estate, about the advantages and challenges that distinguish light industrial from the broader sector, and how Kayne Anderson is deploying its time-tested investment philosophy to stay ahead of the competition. Following is an excerpt of that conversation.

Light industrial real estate has continued to attract long-term capital, even as other sectors face market volatility. What are the sector's fundamentals and how have they created this foundation of stability?

Brian Lessans: The sector's fundamentals have been very stable, even through periods of volatility in the broader industrial real estate market. Supply has been constrained by high replacement costs, often 30 percent to 50 percent above the acquisition basis in the same market, and by infill locations where zoning restrictions frequently limit new development. These assets also benefit from proximity to population centers in high-density markets, which gives them a clear advantage over new development occurring farther outside the urban core. On the demand side, there's enduring need from manufacturing, technology, and distribution users, and that demand has only strengthened with recent reshoring trends. Limited supply combined with durable, growing demand creates a very sensible investment proposition – and I think more investors are starting to recognize that.

Nishant Bakaya: This move to onshore critical manufacturing and new technologies is a major tailwind. There are companies making multibillion dollar investments in semiconductor factories with a whole array of vendors and subcontractors making specialty components within that ecosystem. Those vendors are not looking to build a \$10 billion factory, but they do need 25,000 square feet close to these major factories. We're offering the infrastructure they can base their services and operations out of. One of the greatest things about light industrial is that you don't have the single-tenant risk associated with big-box industrial. You're not buying or building a million-square-foot warehouse 30 miles outside of the city and then hoping you can get a tenant to sign or renew. With multitenant small bay industrial, you can provide a variety of leasing points for these growth companies that are figuring out what they need.

Brian Lessans: There's also a long-term trend of small business growth that plays directly into this model. Our properties accommodate a wide range of tenant sizes, typically ranging from 1,500 to 25,000 square feet within the same park. That flexibility allows tenants to expand or contract without leaving the ecosystem, which creates a mature, grow-in-place environment. That's a huge advantage. And as we build scale in certain markets, that applies not only within the same park, but also to other properties in our portfolio. We are constantly managing tenant leasing at the portfolio level.

We're seeing a clear divergence between the large bay logistics and the small-to-mid-bay industrial assets. What's driving the stronger performance of the smaller format?

Nishant Bakaya: As investors acquire a more sophisticated understanding of the broader industrial real estate sector, they are seeing subsectors within the industrial asset class that cater to different needs. There are big-box, logistics-oriented, five-hundred-thousand-plus-square-foot ideal for major ecommerce/distribution businesses. There are single-tenant buildings for last-mile delivery. There is industrial outdoor storage for transportation. Then there is light industrial, multitenant, infill product. Until recently, investors' predominant interest has been in owning and building big-box, large bay product. It was easy to put money out and also to add supply because there were fewer zoning restrictions. Light industrial is a tougher product to access due to being situated in more desirable infill locations with zoning restrictions. It also requires a robust leasing and property management infrastructure because with higher tenant density, smaller suite sizes and shorter lease terms, it's more complicated operationally. But that same complexity allows you to create alpha. You can move rents more frequently, you can meaningfully change the tenant space, and you can work with tenants in a flexible way to get to the outcomes they want.

Kayne Anderson Real Estate has long focused on investing in sectors supported by durable needs-based demand. How does light industrial fit within that broader investment philosophy?

Brian Lessans: One of the things I really enjoy about our investment philosophy is how hands-on it is. We're not "set it and forget it" allocators – we develop a business plan and focus on execution and value creation, which is a consistent theme across Kayne Anderson's broader strategy. Light bay industrial fits that approach well. Ownership is fragmented, the business is operationally intensive, and success requires active management. We recognized similar structural characteristics when we began investing in medical office in 2013, at a time when institutional participation was limited relative to traditional office despite strong demographics and sticky tenancy. Light bay industrial feels very similar today. Most investors have focused on large bay assets, while small bay has remained underappreciated, even though it is often more fundamentally sound. We like businesses where disciplined execution and active management can consistently generate alpha, and light bay fits that profile extremely well.

Nishant Bakaya: Light industrial fits with Kayne Anderson's investment philosophy very neatly. Historically we have been involved in operationally intensive asset classes – student housing, senior housing, and medical office. The strategic approach is similar. We align with experienced operators who have deep scalable niches. What we are looking for is not a five-year phenomenon, but a 10- to 20-year trend. The alignment must be sector, operator, outlook; those have to align. Then

once it lines up, it moves fast. In the 13 months since we partnered with BKM, we've assembled 5.5 million square feet of light industrial. We are fortunate to have a partner with strong capabilities and a large integrated leasing and operational infrastructure.

The partnership with BKM has been a meaningful entry point into the sector. What has made this collaboration successful? And then how do you see it evolving over time?

Brian Lessans: Small bay industrial is a multitenant, operationally intensive business with real barriers to entry, and having a partner that truly understands both leasing and management is a huge differentiator. There's nobody else as dedicated as they are to small bay. They've built proprietary systems that track virtually every data point, from leasing and property management to construction, and they actively use that data to inform asset management and acquisition decisions. They also have a fully integrated, in-house team, which becomes especially critical as you scale. Leasing is arguably the most challenging part of small bay industrial because of the sheer number of tenants relative to large bay assets. BKM's in-house leasing capabilities are a major differentiator, and we place a lot of value on that partnership.

Nishant Bakaya: Their knowledge of the tenancy base is going to be very effective in helping us scale. BKM is predominantly West Coast now. They are also in Texas and the Midwest. We are helping them enter the Southeast, and we fully intend for our partnership to become national.

Reshoring, local manufacturing, and the growth of service-oriented businesses are positioned to support this asset class for years to come. How are those structural shifts influencing your view of long-term opportunity in light industrial?

Nishant Bakaya: The onshoring of critical manufacturing is not going to be a short-term process. The infrastructure investments being made by some of these large tech and energy companies are 10-plus-year commitments. As far as we can see, the demand from our tenant base to service those investments is going to be there for quite some time. I think we will also see increasing consolidation in the light industrial space. Right now, ownership is fairly fragmented and there is a significant amount of non-institutional ownership.

Brian Lessans: We think we're still in the early innings. As more institutional capital enters the space, light industrial will likely evolve into a more core or core-plus property type over time, particularly given that the supply dynamics are unlikely to change in any meaningful way. Supply is flat to negative and is expected to remain so, driven by high replacement costs and the fact that, in certain markets, small bay properties are being removed from inventory and redeveloped into other uses. All of that reinforces our conviction in the long-term opportunity.

Competition has intensified as more investors recognize this sector's strength. What advice are you following as you stay disciplined while pursuing investment in the space?

Nishant Bakaya: Having strong integrated in-house operating and leasing capability is critical for success. This is not a sector where you can use third-party brokers for all your leasing needs. If you want to control your destiny, you need to have the leasing and operational infrastructure – both human and digital in-house – to be successful.

Brian Lessans: One of the things we like about our structure is that BKM is invested alongside us. They're deeply attuned to market conditions and have real alignment in driving positive outcomes. We stay disciplined by underwriting realistically and remaining highly aware of what's happening at the market and submarket level. That combination of local insight, alignment, and conservative assumptions helps us stay grounded even as competition increases.

As we move through a transitional phase in commercial real estate, what does success in the light industrial space look like during the next five years?

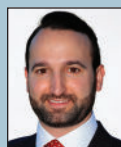
Brian Lessans: We have strong conviction in the sector, and our ambition is to continue scaling the platform nationally over time. Ultimately, success means generating liquidity events that meet or exceed our underwriting expectations and deliver strong outcomes for our investors. That's what we're focused on.

Nishant Bakaya: Success is aligning with BKM on a national basis, developing high-performing portfolios across the country, and setting them up for the right exit. It's being a scaled owner within the asset class, well-positioned to benefit from increasing institutionalization, lower cap rates and continued steady performance in terms of occupancy and rent growth.

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COMPANY OVERVIEW

With approximately \$17 billion of assets under management, **Kayne Anderson Real Estate's** investment objectives are to create strong risk-adjusted returns by focusing on current cash yield and increasing value through cash-flow growth, while remaining sensitive to capital preservation. Since 2007, Kayne Anderson Real Estate has invested in alternative real estate sectors, including medical office, high-end senior housing, off-campus student housing/multifamily and self-storage. Our vertically integrated team brings expertise in all aspects of real estate investing and management to each of our investments, thereby maximizing operating capabilities.

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