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Industrial & Logistics

February 2026 • perenews.com

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KEYNOTE INTERVIEW

Light industrial's transformation takes shape


While the sector remains difficult for institutional investors to navigate, outsized returns are attracting attention, say Kayne Anderson's Al Rabil and Nishant Bakaya

Rent growth in the small-bay, multi-tenant light industrial sector continues to attract institutional investor interest. But beneath the attractive supply and demand fundamentals is a sector that requires unique operational capabilities to grow at scale, explain Al Rabil, Kayne Anderson Real Estate's CEO and co-founder, and Nishant Bakaya, a senior managing director with the real estate investment firm. Still, demand drivers are reshaping the sector as investors seek new ways to generate alpha on alternative investments.

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Q Light industrial has attracted long-term capital even amid broader commercial real estate volatility. What makes the sector so resilient, and why has it continued to earn investor confidence?

Nishant Bakaya: Apart from the already existing imbalance between supply and demand in small-bay light industrial, one of the recent tailwinds for the light industrial subsector is the increased demand for space as the US economy sees more onshoring of manufacturing. The reshoring of critical high-tech manufacturing, such as semiconductors, is bringing manufacturing infrastructure back to the US. Onshoring of manufacturing creates an ecosystem of vendors and networks to supply those large-scale manufacturers, and all these operations need space.

A lot of these businesses are specialized vendors in the broader supply chain. They are not looking to lease one million square feet, but are more often searching for space from 5,000-25,000 square feet. Demand for small-bay industrial is increasing, which is reflected in low vacancy rates and robust rent growth. In addition, not much of this product type has been developed in the last 20 years. The fundamentals of small-bay light industrial reflect a combination of increasing demand and limited supply.

Al Rabil: Few players are focused on this part of the industrial sector, so there is a fair amount of low-hanging fruit in terms of having alpha generation capability. There is an ability to garner attractive risk-adjusted returns from a space that is part of a larger core sector, but within a more specialized subsector.

Small-bay light industrial has different leasing dynamics and very different operating dynamics compared with the traditional industrial sector. The long-duration demand drivers and the strength of the asset class will continue to earn investor confidence.

Q What about this niche property sector makes it so operationally intensive?

NB: Small-bay light industrial buildings require a robust leasing and operational infrastructure to manage. Unlike big-box warehouses, where you can sign a 20-year lease on a 500,000-square-foot building, in light industrial you are managing closer to 150,000-square-foot parks with 25 or more tenants ranging from 2,000- to 30,000-square-foot suite sizes and average lease terms of less than five years. Our operating partner, BKM, has robust in-house operational, leasing and technology infrastructure that has been developed specifically for managing small-bay light industrial.

Many of the tenants are small or mid-sized, growth-oriented companies that have evolving space needs. A tenant may start with 5,000 square feet, then look to move to 10,000 square feet in a few years. The ability to offer a variety of space options and flexible leasing terms is an advantage in servicing these growth companies.

Q What sets light industrial apart from other sectors and how does it line up with other in-demand sectors?

AR: Value creation is central to our investment philosophy. We pursue value-add opportunities that deliver strong risk-adjusted returns, leveraging our sector experience and operating capabilities to achieve value-add outcomes with lower execution risk. We have been looking at light industrial for many years, and in late 2024 we decided it was the right time to enter the sector. Light industrial fits the long-duration demand trend that we are seeking. Very few people are arguing that the US will see less e-commerce in the years ahead. Onshoring is a longer trend, and while not necessary for our thesis, it does provide an additional tailwind.

Combine that demand dynamic with a constriction of new supply and high barriers to entry, and you have the makings of strong rent growth. The sector has a big runway with few highly qualified competitors. That is the same dynamic in other asset classes that we have invested in, like student housing or medical office. We see a lot of opportunities in light industrial going forward. The scaling dynamic is something we have been able to execute in other sectors, and light industrial is off to a strong start.

Q How do scalability, occupier behavior and market dynamics factor into investment underwriting and long-term returns in this sector?

NB: Scalability in the space is a challenge because of the operational intensity required to manage the large number of tenants. A very strong operational infrastructure is needed, with a lot of standardization and process built around tenant management. Our partnership with BKM is able to bring professionalism and standardization to generate scale. BKM was primarily a West Coast operator. We have been constructive in bringing them to other parts of the country and I anticipate us being broader across the US over time, but it ultimately depends on the underlying markets.

Small-bay light industrial has flown under the radar, and now people are seeing how robust the sector

Q Strong fundamentals are often cited as the sector's backbone. Which demand and supply dynamics matter most, and are investors confident they will hold over time?

NB: We see onshoring and the continued rise of e-commerce as long-term secular demand trends. While there is a decent supply of big-box industrial, there is not enough supply of small-bay light industrial to meet the need. Vacancy for industrial buildings below 100,000 square feet is around 5 percent today – for big-box industrial, that number is closer to 10 percent.

Unlike big-box industrial, which can be built 30-plus miles from urban population centers, small-bay light industrial tenants have a strong preference for infill locations with proximity to business and residential centers, to best meet the needs of both their clients and their employees. These infill locations tend to have restrictive zoning, limiting the amount of new supply that can come to market. This lack of supply has led to small-bay light industrial outperforming big-box industrial.

fundamentals are. High occupancy, strong rent growth, limited re-leasing risk and the ability to rapidly backfill at attractive rents when tenants leave make this a very attractive industrial subsector.

AR: BKM brings a level of expertise with their boots on the ground. We bring the capital and the ability to scale, allowing our partner to focus 100 percent of their time doing what they do best. Across our platform, we have had success aggregating portfolios and ultimately selling to LP-oriented investors because of our ability to tailor bespoke portfolios to meet their needs.

Q How do you see investor appetite for light industrial evolving in the years ahead?

NB: Investors are taking a more nuanced approach in how they look at niches within the broader industrial asset class and it is clear that small-bay light industrial will become a key area for investment. Within the sector, I expect that we will see the emergence of a few national players that capture more market share over time, with more standardization, more consolidation and more investor interest driven by the robust demand and supply fundamentals, especially here in the US.

AR: Looking forward, small-bay light industrial will likely be recognized as a core part of the greater industrial sector, with sustained investor activity across the asset class. It was the same with medical office, senior housing and student housing. Those industries are dominated by a concentration of successful players with operational expertise that is not easily replicated. The vast majority of participants in any asset class are beta players – very few can create significant alpha. That is one reason why we have not invested in data centers – it is crowded and we are not interested in being a beta investor in anything. There are lots of asset classes that can raise significant capital, but we know what disciplined investing really looks like. ■

"Small-bay light industrial has different leasing dynamics and very different operating dynamics"

AL RABIL

SOURCE: BKM

The Shoreline Business Center is an 84,433-square-foot, multi-tenant business park in Fremont, California

"Demand for small-bay industrial is increasing, which is reflected in low vacancy rates and robust rent growth"

NISHANT BAKAYA