Less is more

Small to midsize industrial is positioned for outperformance

Small and midsize industrial properties — typically less than 300,000 square feet — have emerged as a resilient bright spot, maintaining low vacancy, continued demand and significantly less competition from new supply than larger buildings.

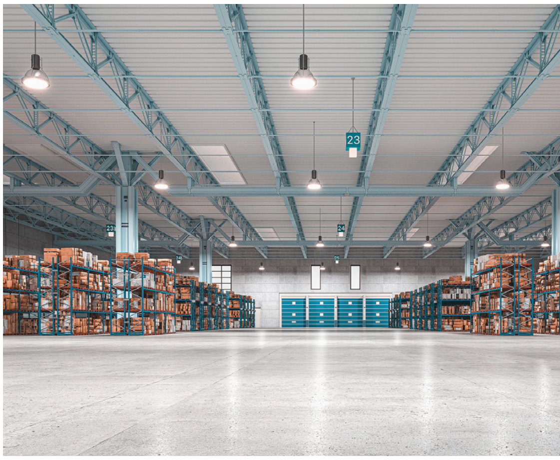
These assets continue to benefit from long-term structural demand drivers such as ecommerce expansion, reshoring and growth in advanced manufacturing, while also facing less supply-side pressure, particularly in infill locations. With tighter supply dynamics, faster leasing velocity, and significant embedded rent growth potential as below-market leases roll over, they offer investors a compelling combination of resilience, demand durability and attractive risk-adjusted returns.

A big part of their strength comes from a structural supply imbalance. While smaller buildings represent 71 percent of the national industrial inventory, they have accounted for only 38 percent of new development since 2022. That mismatch has kept vacancy rates low and competition for space high, especially in dense, infill markets where land constraints and construction costs limit the feasibility of new supply. Properties of less than 300,000 square feet have had an average vacancy rate of 5.7 percent since 2015 and have not exceeded 8 percent over that time period — a level few asset types can match in today's environment.

Rent growth trends unlock significant upside. The industrial market heated up earlier in the decade as new construction fell behind surging demand during the COVID pandemic. Rents for industrial buildings smaller than 300,000 square feet spiked by 39 percent from year-end 2021 to year-end 2023. While they have since rebalanced to near 2 percent rental growth by year-end 2024, rents have increased by 9.8 percent per year on average over the past five years. That's an important context for what comes next. As leases expire, market rents have moved significantly higher, creating embedded rent growth of 40 percent to 60 percent in some cases, as leases reset over the next few years.

Looking beyond rents and vacancies, small and midsize industrial real estate also benefits from secular demand tailwinds. Ecommerce continues to shape space needs, especially for last-mile and urban distribution. At the same time, reshoring efforts are driving a resurgence in domestic manufacturing, particularly across the Midwest and Southern states. Advanced manufacturing sectors such as automotive, semiconductors and clean tech are expanding, and the suppliers and logistics partners that support them are often housed in smaller, flexible spaces. States including Texas, Tennessee, Florida, Arizona and the Carolinas are attracting not only people but a growing share of business investment, pushing local demand higher.

Smaller industrial projects trade in a consistently liquid market. Sales volume of $25.1 billion in 2024 was 26 percent higher than the 2017 to 2020 pre-pandemic average. In 2021 to 2022, this figure nearly doubled to $45.4 billion. Average cap rates vary by building and location quality. Adjusting for quality, stabilized high-quality small and midsize industrial properties traded on average up to 40 basis points higher than properties larger than 300,000 square feet in 2024. But this isn't only a story of higher yield — it's also about more reliable performance. Sixty percent of leasing activity over the past five years has occurred in buildings 300,000 square feet or smaller. Moreover, many tenants



are local, service-oriented businesses with long-standing ties to their location and limited incentives to relocate, supporting lower turnover and steadier cash flow.

Meanwhile, elevated construction costs and tighter financing conditions are suppressing new development, especially in high-cost infill zones. Square footage under construction as of first quarter 2025 is down by 15 percent from average levels in 2024 and half the peak levels of 2022. Completions are forecast to decline through 2026, reaching their lowest point in almost a decade. This will only reinforce the value of existing assets, particularly those in established industrial corridors that are increasingly difficult to replicate.

In short, while the broader industrial market recalibrates, the small and midsize segment is uniquely positioned. It offers a blend of supply constraints, income durability and mark-to-market rent potential that few other property types can match at present. As institutional capital reevaluates risk, expect this market to punch well above its weight in the next phase of the cycle.

Wade Lau is president and CEO of **Founders Properties.**