



BKM Capital Partners

The Ripple Effect of E-Commerce

THE CASE FOR LIGHT INDUSTRIAL



BKM INTEL | THOUGHT LEADERSHIP SERIES

INTRO

The rise of e-commerce, defined as the buying and selling of goods and services online, has transformed consumer behavior and reshaped our view of traditional retail. Originating in the early 1970s, e-commerce began as a niche market but quickly evolved with the growth of the internet and digital technologies. Over the past few decades, it has expanded at an unprecedented rate, fueled by advancements in technology, changes in consumer expectations, and supply chain rifts caused by the COVID-19 pandemic.

In its early days, e-commerce was limited to simple business-to-consumer transactions. With innovations like secure online payment systems and faster delivery options, the sector has grown into a multi-trillion-dollar global industry, with global e-commerce sales forecasted to grow from \$5.13 trillion in 2022 to \$8.09 trillion by 2028.¹ Major players such as Amazon and Alibaba have led the charge on this movement, pushing the boundaries of what e-commerce can offer and setting new standards for accessibility and convenience.

The growth of e-commerce has had a profound impact on the industrial real estate sector. As demand for quick, efficient delivery has surged, so too has the need for strategically located industrial spaces to store and ship goods. Specifically, small-bay industrial assets have emerged as standout performers, offering proximity to dense population centers and flexible layouts that cater to businesses of varying sizes.

This evolution has fueled a sharp rise in light industrial demand, creating a competitive market for high-quality spaces and solidifying e-commerce as a pivotal driver of the sector's recent success.

HISTORICAL GROWTH AND EVOLUTION

To truly understand the impact of e-commerce, it is important to recognize the growing divergence within the broader industrial sector. Recalling the recent cool-down in demand combined with the accumulation of newer, larger warehouse space, big-box industrial facilities experienced large fluctuations in vacancy and leasing activity throughout 2023 and 2024. In stark contrast to this market dynamic, small-bay industrial properties have continued to reap the benefits of this secular shift. Last-mile logistics and its smaller space requirements have created a greater need for infill, small-bay space to keep up with consumer demand for quicker delivery times. As consumer preferences evolve to favor online shopping and the availability of light industrial space remains limited, the sector is poised to experience continued tailwinds.

Early Beginnings - Pre-and Post-Mobile Phone Boom

The origins of e-commerce can be traced back to the 1970's, when English inventor Michael Aldrich created the first online system that allowed consumers to connect with businesses electronically. It was not until 1982 that the first online marketplace was created, named the Boston Computer Exchange. Finally in 1995, the world saw the launch of what would become two of the world's largest e-commerce platforms: E-Bay and Amazon.

With the massive launch of the World Wide Web in 1993, e-commerce would finally be given the platform to connect millions of consumers to products on a new web-based interface. With what seemed like limitless possibilities, consumers slowly began to explore the troves of online browsing. Though not particularly popular at the time due to online safety concerns and hesitancy toward new technology, the internet boom primed consumers to the idea of a more convenient shopping experience. Though exciting, this concept would be once again turned upside down by the mobile e-commerce race that accelerated in the early 2000s.

Over time, e-commerce has become increasingly convenient for consumers, and the mobile phone is no exception. After Amazon debuted its mobile website in 2001—a first of its kind—the race to capture the mobile marketplace was in full swing. The introduction of smartphones marked another major turning point in e-commerce history, creating an interface where consumers could accomplish just about anything from their pocket-sized device.

Currently over half of the world's population owns a smartphone, equating to about 4.9 billion people.²

Pre-Pandemic

Prior to the pandemic, shopping malls were a critical channel for consumer spending in developed economies, serving as a major holdback for the late adopters who only began to embrace e-commerce more recently. In the two decades that passed between the mobile phone boom and the COVID-19 Pandemic in 2020, e-commerce grew at a moderate pace to become an important part of the American economy. Whereas e-commerce made up just 7% of total U.S. retail sales in 2015³, its share of retail sales rose steadily over the next half-decade, growing at a CAGR of 14% through 2020.⁴

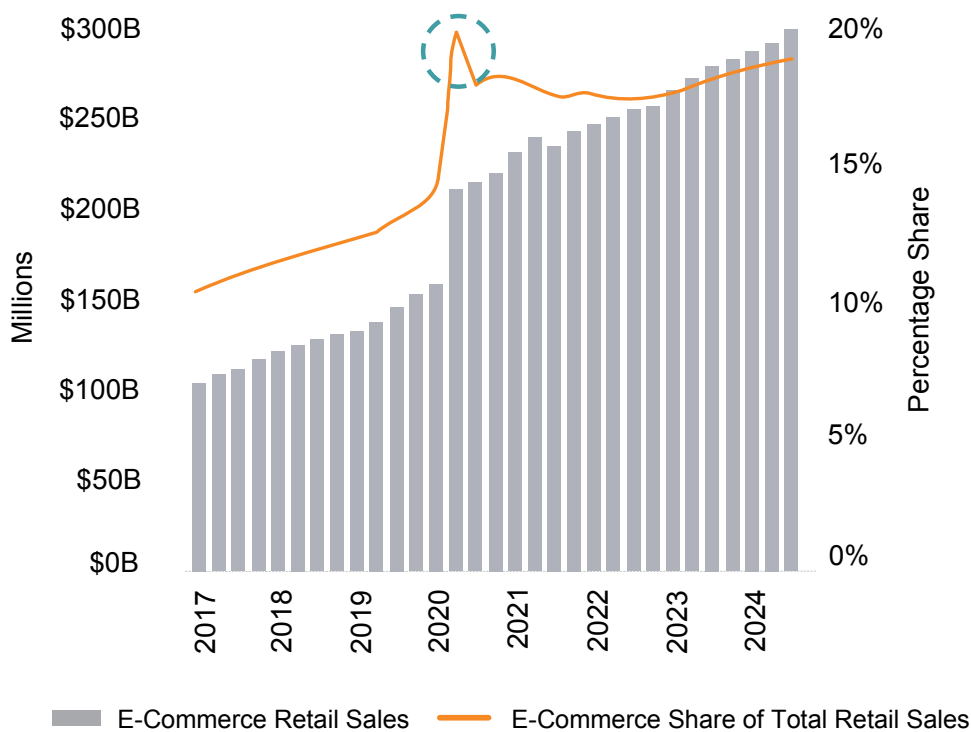
A major driver of pre-pandemic online shopping was Amazon Prime, which was launched in 2005 as the first platform of its kind to offer free, two-day delivery on most orders for an annual fee. This subscription service became a catalyst for what would become a major evolving consumer preference: faster delivery times. This seemingly impossible feat became widely recognized as the new industry standard, prompting other online retailers to find ways to follow suit to remain competitive. The market's rapid evolution also renewed focus on implementing stronger security measures to address new user privacy and safety concerns. These advancements ensured fast and secure online transactions, easing the doubts of skeptical users and providing another reason to embrace online shopping.

Post Pandemic

The COVID-19 pandemic proved to be one of the most significant global events in recent history, having cascading effects on the economy, business operations, and overall human interaction. The pandemic was also unquestionably one of the largest drivers of e-commerce, allowing consumers to continue their shopping routines from the comfort and safety of their homes. This new era of online retail brought significant advancements in e-commerce and technology, eliminating the inconveniences of traditional retail shopping and prompting retailers to shift allocations toward e-commerce initiatives.

In Q1 2020, 47% of Americans reported that they had reduced their spending on day-to-day in-store purchases as a result of COVID-19.⁵ Analyzing Census data from that period, FTI Consulting found that e-commerce accounted for 87% of the surge in retail sales in 2020, when the majority of brick-and-mortar stores were closed.

E-Commerce Sales and Share of Total Retail Sales



Source: U.S. Census Bureau, Yardi Matrix

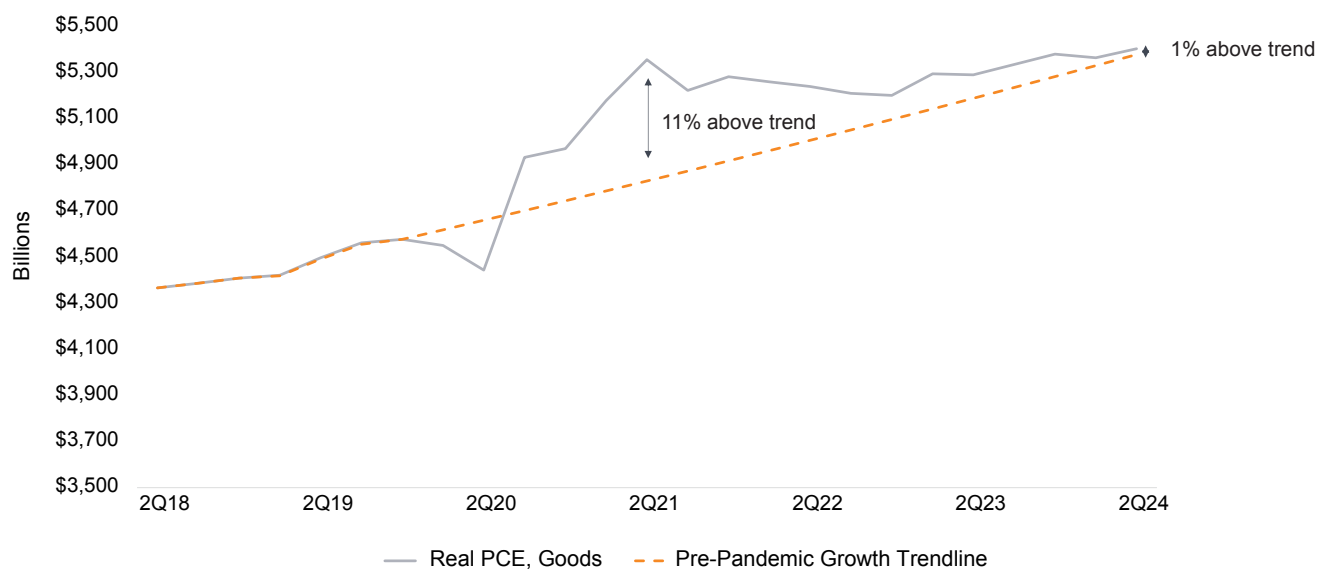
The concentration of e-commerce within the share of total retail sales has experienced significant growth since 2017, with a major spike occurring at the start of the pandemic in 2020. Despite a minor slowdown around 2022, e-commerce has regained its growth streak, reaching a record \$300B in sales in 3Q 2024.



It is clear that convenience has become a lasting priority for consumers. As of 2023, a staggering 43% of Americans said they would still prefer to shop mostly online as opposed to in-store.⁶ This dichotomy only further cosigns the paramount affect that COVID-19 had on the consumer shopping experience, a shift that will continue to shape the retail landscape in the future.

Consumers have remained resilient in their spending activity in the face of economic concerns and rising inflation. They continue to spend at higher-than-expected levels, driving sustained demand for goods and services.

Real Personal Consumption Expenditures, Goods



Source: St. Louis Federal Bank, Newmark Research, October 2024.

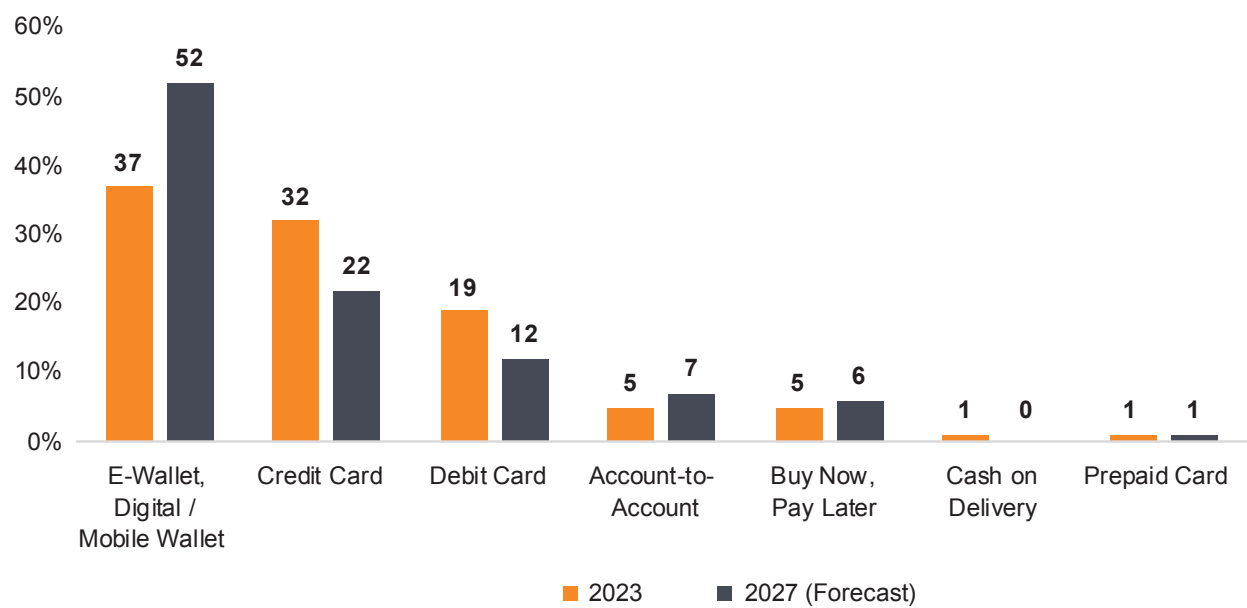


TECHNOLOGY AND EVOLVING CONSUMER PREFERENCES

Payment Platforms

Various methods of payment are now available on B2C marketplaces, allowing users the opportunity to choose their preferred form of payment based off their available funds and credit preferences. Buyers may now choose from numerous payment options at checkout, including traditional credit/debit transactions, digital wallets like PayPal and Apple Pay, and the increasingly popular “Buy Now, Pay Later” (BNPL) program.

Most Used E-Commerce Payment Methods, in Percentage, United States, 2023-2027



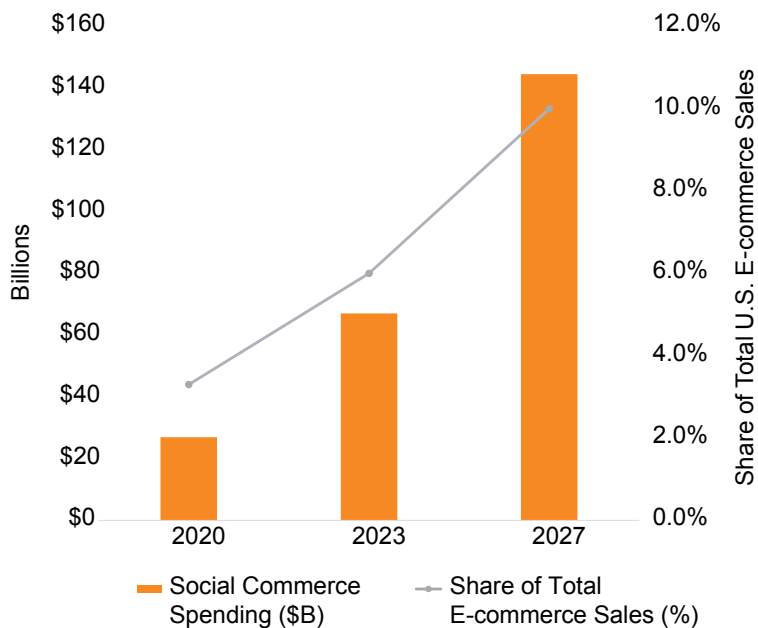
Source: Mordor Intelligence, Worldpay.



Social Commerce

The rise of more personalized shopping experiences has become greatly popularized—notably among GenZ—with social media platforms now offering unique shopping experiences within their native programming. The most prevalent example is Tik Tok, which launched the now highly popular “Tik Tok Shop” in late 2023. This feature allows businesses to promote and sell products within the app itself, seamlessly integrating product placements with the Tik Tok content in each user’s customized feed.

Social Commerce Sales and Growth Forecast



Source: EMarketer, October 2024.

» This increasingly popular form of e-commerce is taking the mobile shopping scene by storm, with the top cohort of online shoppers showing no signs of slowing down any time soon.

▶▶ **Social commerce sales are projected to more than double to \$144.5 billion by 2027 from \$67 billion in 2023, consuming 10% of all e-commerce sales.⁷**

» With younger, more tech-savvy generations beginning to enter their prime spending years, e-commerce is expected to stay a largely popular form of consumption.

Rising Consumer Demand for Rapid Delivery

Consumer behavior observed during the pandemic drew a clear conclusion that emphasized an increase in demand for faster delivery times, leading to a restructuring of local supply chains and emphasizing the need for more developed last-mile infrastructure.

A McKinsey study predicts a 78% growth in urban last-mile deliveries by 2030, translating to a skyrocketing need for infill industrial sites in local urban centers. This demand for convenience has also spurred the introduction of new technologies like drone delivery and EV delivery vehicles, marking a fundamental shift in the operation of the U.S. supply chain.

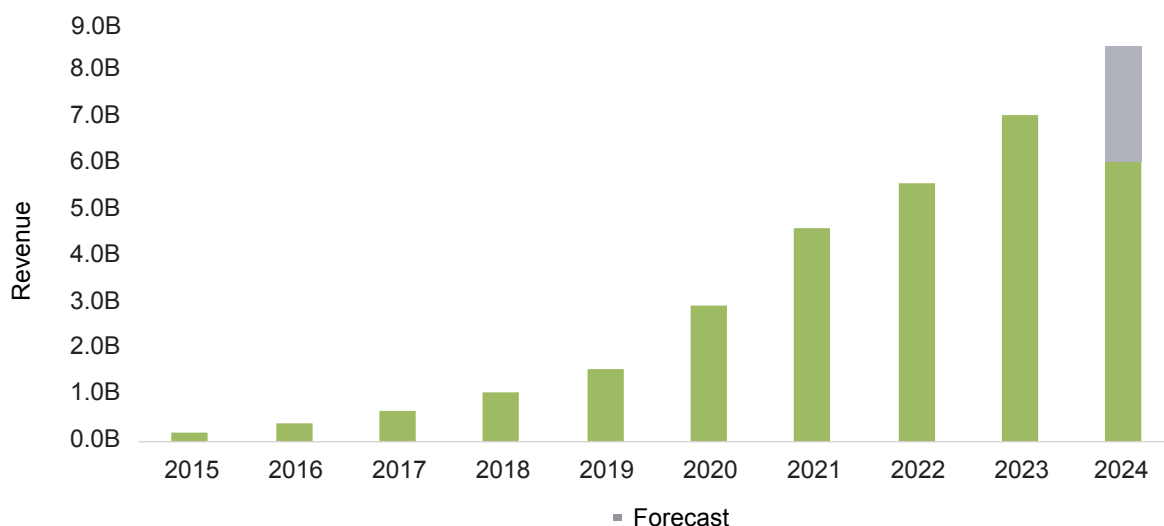
The shift in demand driven by e-commerce and logistics growth has also spurred the repurposing of office properties into industrial space to meet rising space requirements. At the first quarter 2023, 15.2 million square feet of office space nationwide was being converted to industrial use, a 33.7% increase over two years.⁸ In total in 2023, 100 office conversions were complete, which was more than double the annual average of 41 properties between 2016 and 2022.⁹ Though a majority of office conversions often end as multifamily assets, this trend maintains the notion that industrial assets continue to show consistent value across the broader commercial space.



CASE STUDY: THE RISE OF SHOPIFY

Shopify has emerged as a dominant force in the e-commerce industry, reshaping how businesses—large and small—reach customers online. Shopify has been on a major growth trajectory since its inception in 2006 and is one of the most popular platforms driving e-commerce today. As of August 2024, Shopify powers over 5.23 million active websites, highlighting its vast influence and expansive market reach.¹⁰

Shopify Yearly Revenue



Source: Macrotrends, Yaguara, 3Q 2024.

This growth is cosigned by Shopify's financial success, as shown in its revenue trajectory above. In 2022, Shopify reached new heights with revenue exceeding \$5 billion, marking a steady increase from the company's earlier years. In Q3 2024, Shopify revenue reached about \$2.2 billion, growing 26% year over year. This marked the highest revenue in a single quarter to-date for the company.¹¹ Additionally, Shopify now controls approximately 24% of the U.S. e-commerce software market, making it a major influencer in the broader online retail market.¹² Supported by a workforce of over 8,300 employees, Shopify's infrastructure and support network continue to provide a steppingstone for online retailers across the globe.

Shopify's ascent to becoming an e-commerce giant not only reflects its robust business model but also serves as a testament to the shift in global favor towards online shopping. As e-commerce continues to grow, Shopify remains at the forefront of market share and innovation, providing a scalable platform for businesses to thrive in the digital marketplace.

AI and AR

Notably one of the most talked about advances in recent technology is the rapid proliferation of artificial intelligence (AI) and augmented reality (AR) solutions, now available in the form of numerous tools such as ChatGPT, image readers and generators, AR shopping resources, and more. The advanced capabilities of these AI tools have fueled the growth of e-commerce by integrating these technologies into popular online shopping platforms, further improving user experience and encouraging consumer conversion to online marketplaces.

AI-powered algorithms analyze customer data to provide tailored recommendations, improving customer satisfaction and further driving sales. With predictive analytics, AI helps retailers forecast demand, optimize inventory, and enhance customer service through chatbots that offer 24/7 support. Meanwhile, AR allows customers to visualize products in their real environment before purchasing—whether it's seeing how furniture fits in a room or trying on virtual clothes. This “try-before-you-buy” approach reduces return rates and increases customer confidence. Together, AI and AR are reshaping e-commerce, creating a seamless, engaging, and efficient shopping experience that bridges the gap between physical and online retail.

Studies show that consumers are pleased with the augmented reality tools that are in-place to enhance their shopping experience, with 36% of consumers ages 18-29 and 31% of consumers ages 30-39 citing AR functions as “very helpful” in their online shopping experience.¹³



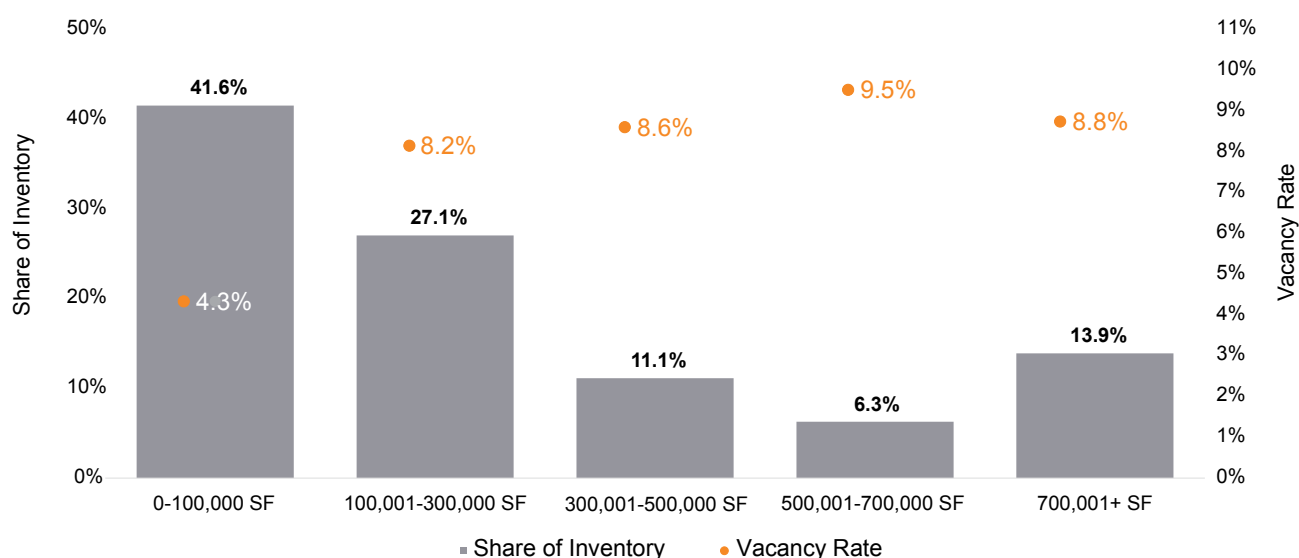
IMPACT ON INDUSTRIAL

The industrial sector, specifically small-bay assets under 250,000 SF, has experienced compelling fundamentals despite the prolonged high-interest rate environment and persistent economic uncertainty. Even with the blitz of industrial completions that hit the market in previous quarters—a direct response to the recent explosion in demand—the small-bay sector remained insulated, maintaining its attractive supply / demand balance. A large majority of recent completions comprise properties over 250,000 square feet, forcing large-bay owners to cope with rising vacancy rates and decreases in net absorption. Conversely, small-bay industrial properties face heavy supply-side pressures as a result of their infill nature and high construction costs, making it extremely difficult to produce new product. As a result, the small-bay sector is continuing to post positive gains in NOI and overall pricing, fundamentals not seen in any other segment.

Demand Drivers

Three major drivers of industrial growth have propelled the sector to new heights over recent quarters: **Onshore manufacturing, technology and automation, and e-commerce**. In particular, the explosion of e-commerce in place of traditional retail consumption has driven the need for more warehouse and fulfillment centers. This e-commerce-fueled growth trajectory is anticipated to persist, with Moody's Analytics forecasting the sector to double in size by 2034 and CBRE projecting it to capture 30% of non-auto retail sales by 2029. With consumers now demanding faster delivery times and retailers experiencing higher inventory turnover, the result is companies searching for infill industrial properties that can fulfill their increasing logistics and last-mile distribution needs. Evidently, availability rates for the small bay sector remain at historical lows, hovering around 4.3% in 2024 as opposed to big box spaces that post rates between 8 and 10%.

3Q 2024 Industrial Vacancy Rate by Building Size



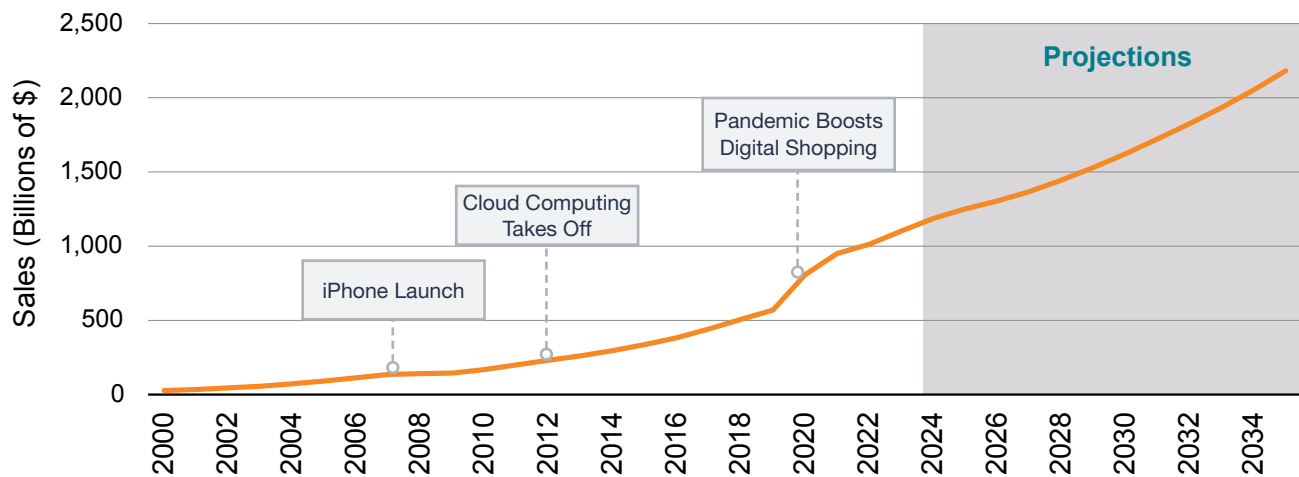
Source: CoStar, Newmark Research, October 2024.

Delivering smaller shipments of goods to consumers in a way that is time-efficient and cost-conscious is a problem that has long plagued retailers who are seeking to diversify their supply chain. With supply-side pressures and geographic constraints posing development hurdles in large urban areas, many occupiers turned to infill small-bay warehouses to meet their growing distribution needs. Considering the cost of warehouse rent only accounts for around 4-5% of overall supply chain costs, businesses are often more concerned with lowering their transportation costs, rather than lowering the cost of rent.¹⁵ When selecting a site for these last-mile facilities, their focus remains on location, diversification, and route optimization, making small-bay warehouses in central locations often the most logical choice.

Though leasing has waned in the latter part of 2024 due to the presidential election, economic uncertainties, and softening fundamentals, the leasing market is expected to normalize and resume growth further into 2025. With the pressure looming to move larger volumes of goods at faster speeds, e-commerce and third-party logistics companies are implementing increasingly aggressive leasing approaches. E-commerce supply chain operations typically require three times more warehouse and logistics space than traditional brick-and-mortar supply chains due to their diverse and complex consumer product pathways.¹⁵ As such, online retailers need an estimated 1.2 million square feet of logistics space for every \$1 billion in e-commerce sales, according to Prologis research. As e-commerce trends upward, space requirements are likely to expand.

US Total Annual Retail E-Commerce Sales

Sales expected to double in little more than a decade



Source: Invesco Real Estate, utilizing data from Moody's Analytics as of August 2024.



Logistics and 3PL

- » According to JLL, one of the leading drivers of industrial demand today is the logistics, distribution, and 3PL sector. This dominance is not new, as the sector has held this top position for five consecutive years since 2020. JLL's research also highlights a nearly 66% increase in demand for this sector between 2020 and 2024, underscoring the critical role logistics plays in sustaining industrial growth.



Traditional Retailers

- » Traditional retailers have also emerged as a major player in overall demand, utilizing omnichannel methods such as buy-online-pick-up-in-store to increase their logistics and distribution needs. This sector, combined with consumer products, have accounted for over 100M square feet of active requirements that continue to drive the growth of the industrial sector.¹⁶



Food and Beverage

- » The growth of online grocery shopping has provided yet another need for warehousing and distribution centers. The rise in population (currently just under 334 million people in the U.S.) has resulted in higher demand for both fresh and frozen goods, requiring more specialized cold-storage facilities to accommodate these increasing needs.



Onshore Manufacturing / Nearshoring

- » A study conducted by McKinsey that surveyed over 100 supply chain leaders found that in 2023, about 43% of respondents reported a shift to nearshore production, nearly triple the share from one year prior. Having a significant influence on national and local supply chains, the continued investment in local manufacturing infrastructure will continue to help prop up local industrial markets.



Demand Bolstered by Logistics

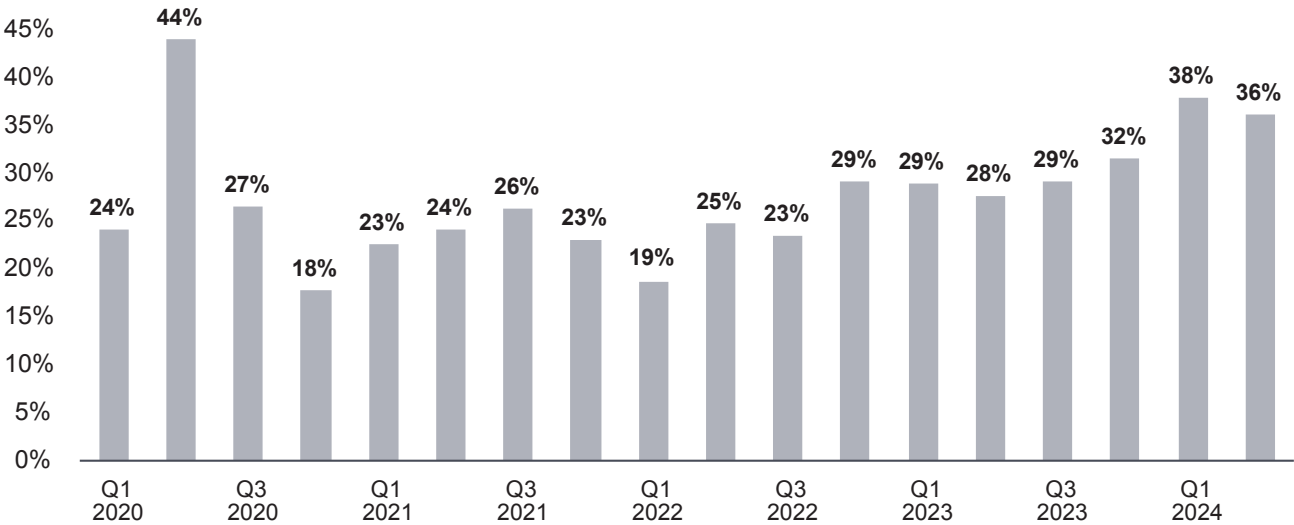
- » Logistics and parcel delivery now represent over 23% of new market requirements, further providing evidence that the industry is growing in response to an influx in e-commerce-related consumer demand.¹⁶



Leasing Spreads Reflect Persistent Value of Industrial Assets

- » Trends have pointed toward a shift in occupier requirements that now favor newer buildings with modern amenities. Higher quality industrial assets that offer tenants access to local distribution networks continue to experience the highest demand, along with the ability to command premium rents.

BKM Historical Leasing Spreads



**Based on a weighted average of SF executed across all active regions.*



Leasing Stays Strong in Key Sectors

- » Although the national vacancy rate has softened after a record-breaking few years, leasing activity for smaller spaces under 300,000 SF has continued to dominate over 65% of all industrial leases nationwide as of Q3 2024.¹⁷
- » Additionally, 30% of the top leasing activity in 2024 consisted of the logistics, distribution and 3PL industry, while e-commerce and retailers represented over 26% of the top leasing activity.¹⁷



Development Remains Concentrated in Larger Properties

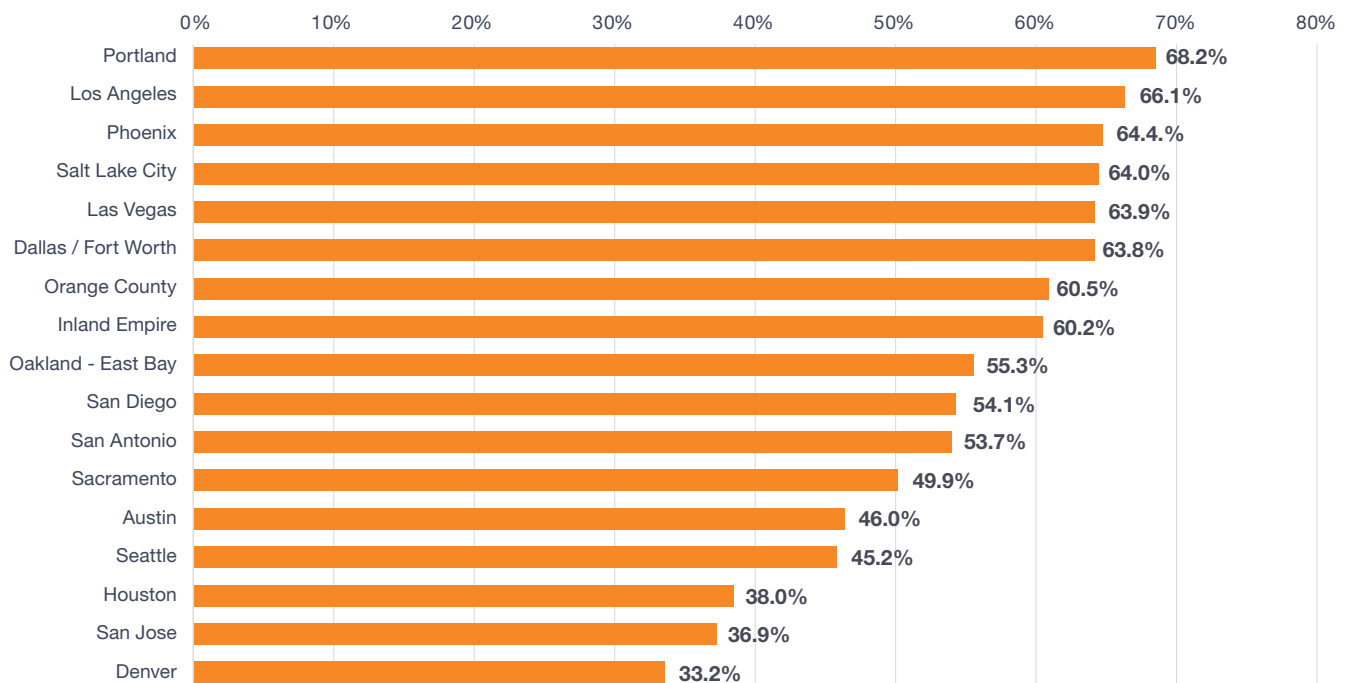
- » Light industrial properties have also been obscured from the recent development pipeline. New industrial development from previous quarters has been mainly concentrated in larger buildings, with small-bay construction figures hovering near 5% of the total industrial SF under construction.¹⁸ Small-bay assets are hence shielded from the oversupply challenge we have seen rush over the big box space in recent quarters. This, coupled with the elevated requirements seen from e-commerce and logistics companies, has driven a strong case for light industrial's continued success.



Historic Rent Growth

- » Converging factors such as sustained demand from key growth industries and a slim development pipeline for small-bay properties has resulted in exceptional rent growth across the past five years, something BKM has been poised to take advantage of. Key Western markets have seen figures skyrocket between 30% and 68% since 2020, allowing operators like BKM to achieve exceptional risk-adjusted returns.

Cumulative Industrial Rent Growth - BKM MSAs (2020-2024 YTD)

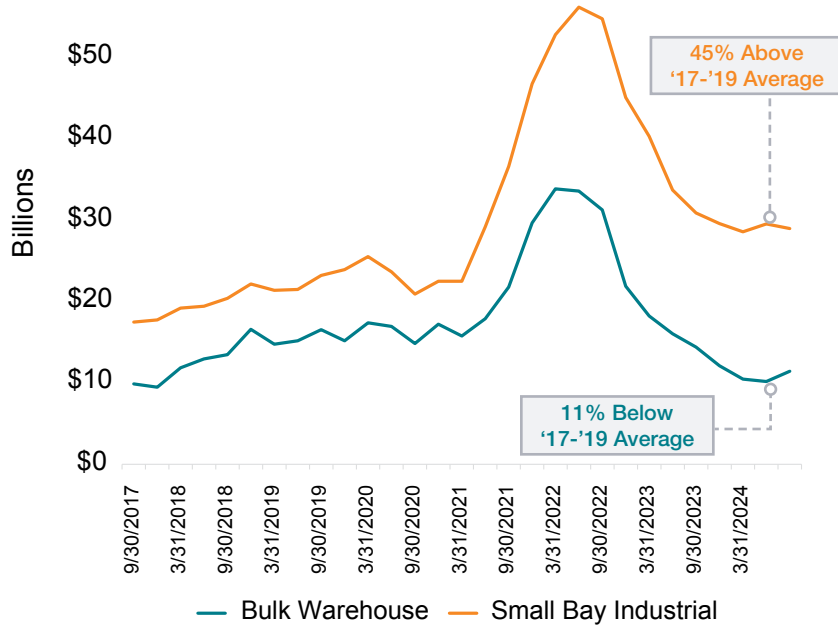


Source: BKM Intel, November 2024.



Light Industrial Sales Volume Outpaces Historical Averages

Small Bay Industrial vs Bulk Warehouse, 4Q Rolling Sales Volume



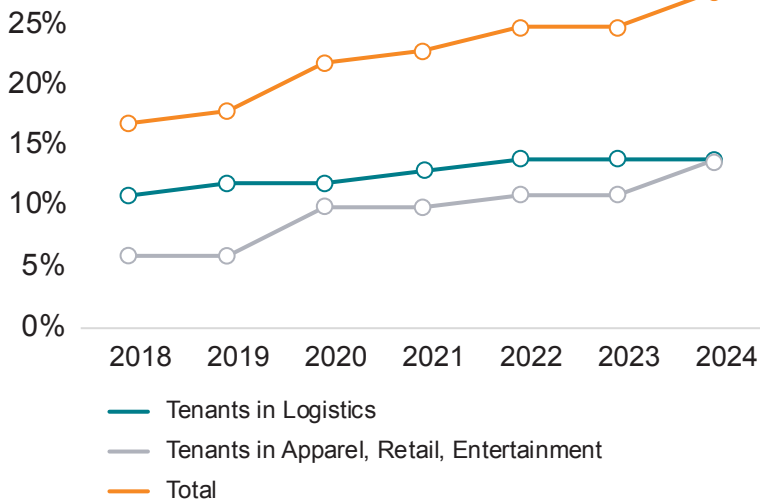
Source: Newmark Research, October 2024.

The small-bay industrial sector has consistently traded at more favorable pricing than the bulk warehouse sector, with sales volumes consistently soaring above historical averages. In contrast, bulk warehouses experienced a sharp decline following their pandemic-era peak. This highlights the resilience and continued growth of the small-bay sector, underpinned by more attractive pricing dynamics and sustained demand for the product type.



Evolving Tenant Concentrations Cosign Secular Shifts

BKM Historical Tenant Concentration



BKM's tenant concentration in e-commerce-related industries has steadily increased since 2018, aligning with broader industrial trends. At the same time, the firm has historically maintained a well-diversified tenant base, effectively hedging its portfolio against financial and economic risk.

CHALLENGES OF E-COMMERCE DEMAND

1 Labor Shortages

Challenge: The industrial sector is contending with labor shortages, particularly in warehousing and logistics roles. This high demand for labor is driving up wages and operational costs, prompting companies to invest in automation to mitigate the impact on profitability.

Mitigant: To address this, companies are increasingly investing in innovative solutions such as automation technologies, where robotics, conveyor systems, and artificial intelligence can reduce reliance on manual labor. Additionally, workforce development initiatives, partnerships with local educational institutions, and competitive compensation packages are proving effective in attracting and retaining skilled workers.

2 Supply Chain Disruptions

Challenge: The COVID-19 pandemic exposed supply chain vulnerabilities, pushing companies to increase inventory and adopt “just-in-case” strategies to increase inventory levels. While this shift has driven higher demand for industrial space, it also introduced greater volatility, complicating demand projections.

Mitigant: Companies can adopt diversified supply chain models by sourcing from multiple regions to reduce dependency on a single point of failure. Leveraging real-time supply chain monitoring tools and predictive analytics can improve forecasting and enhance resilience against disruptions. Developing local or regional supply chains can also reduce risks associated with global logistics challenges.

3 Sustainability Pressures

Challenge: Environmental concerns are intensifying as the industrial sector grows. Stakeholders are increasingly demanding sustainable practices, including green building certifications and energy-efficient designs. While these initiatives support environmental goals, they can drive up development costs and limit viable locations for new facilities.

Mitigant: Developers can leverage government incentives, such as tax credits for green building initiatives or renewable energy installations, to help offset costs. Investing in energy-efficient technologies, like LED lighting and solar panels, can reduce long-term operating costs. Collaboration with ESG-focused investors can also secure funding for sustainable projects, aligning environmental responsibility with long-term profitability.

4 Zoning and Regulatory Challenges

Challenge: Demand for last-mile delivery space has led to intensified competition for locations in infill, high-density population centers. However, zoning regulations often delay projects or limit options. Further, local opposition, fueled by concerns over congestion and environmental impact, adds another layer of complexity.

Mitigant: Developers can proactively engage with local governments and communities to address concerns and advocate for favorable zoning changes. Adopting community-friendly practices, such as traffic management plans, noise reduction measures, and sustainable building designs, can ease opposition. Mixed-use developments that integrate industrial with other uses (e.g., retail or residential) can also help navigate zoning restrictions more effectively while fostering community acceptance.

OUTLOOK

Several key trends will shape industrial real estate as e-commerce continues to evolve.

Automation and Technology Integration: The adoption of automation technologies, including robotics and AI, is becoming essential for effectively meeting e-commerce demands. Facilities equipped with advanced technology are likely to command premium rents, as they offer operational benefits that reduce dependency on labor.

Evolving Consumer Expectations: Consumers' desire for fast delivery drives demand for last-mile facilities near population centers, particularly in urban markets. Developers are increasingly repurposing older, infill properties or building smaller distribution centers to fulfill this need, intensifying competition for space in prime locations.

Sustainability and Environmental Initiatives: ESG considerations are influencing investment decisions, with a focus on energy efficiency and green building certifications. While these trends may raise development costs, they can significantly enhance property value as tenants and investors prioritize sustainability. Sustainable supply chain solutions, such as green fleets and other low-emission alternatives, are set to impact both e-commerce and industrial investment.

Potential Market Corrections: Unlike some other product segments, industrial valuations remain steady or are on the rise. Despite this robust demand, the sector could be rocked by a potential slowdown in e-commerce growth or a higher-for-longer interest rate environment. Investors are closely monitoring these dynamics to navigate potential shifts in market conditions and property values.

Geopolitical and Supply Chain Resilience: Companies are diversifying supply chains to reduce risk, driving demand for industrial spaces in emerging regions. This trend is creating new logistics hubs and redistributing demand across a wider geographic footprint.

CONCLUSION

The ongoing expansion of e-commerce presents a transformative opportunity for the industrial real estate sector, with small-bay facilities uniquely positioned to thrive. As consumer preferences for faster delivery and convenience drive demand for strategically located properties, the light industrial market remains ideally suited to capitalize on these trends. However, addressing challenges such as labor shortages, sustainability pressures, and supply chain disruptions will be critical to unlocking the sector's full potential. By embracing advancements in technology, automation, and green infrastructure, the light industrial sector can not only navigate these challenges, but also drive innovation, resilience, and growth. As e-commerce continues to evolve, the industrial sector's adaptability will be essential to maintaining its vital role in an increasingly digital economy.

SOURCES

¹Shopify, October 2024

²Backlinko, March 2024

³U.S Census Bureau, 3Q 2024

⁴Influencer Marketing Hub, November 2022

⁵Statista, March 2020

⁶Statista, March 2023

⁷Emarketer, October 2023

⁸Commercial Observer, June 2023

⁹GlobeSt.com, September 2023

¹⁰Demandsage, November 2024

¹¹Digital Commerce 360, August 2024

¹²Demandsage, August 2024

¹³Statista, March 2024

¹⁴NAIOP Research, 3Q 2022

¹⁵CBRE Research, March 2016

¹⁶JLL Research, 4Q 2024

¹⁷CoStar, Newmark Research, 3Q 2024

¹⁸CoStar, February 2024



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 100 employees in 13 offices, BKM Capital Partners implements a value-add strategy targeting under-managed and under-capitalized assets. The team has invested over \$4.5 billion in over 120 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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