KBC INSIGHTS INVESTMENT STRATEGIES

Development: A Rising Rate Insurance Policy

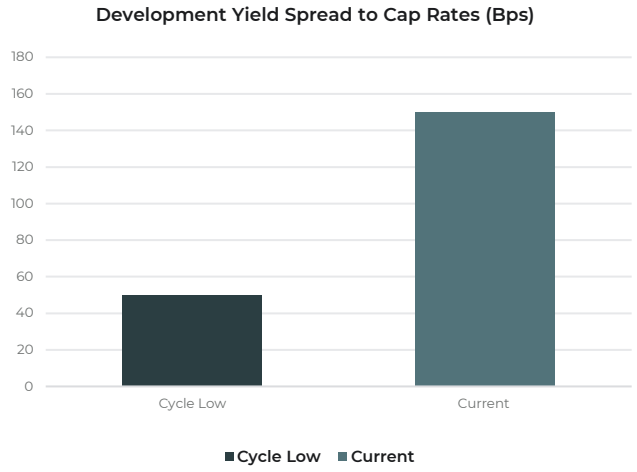
Development can be an insurance policy against possible higher interest rates and cap rates

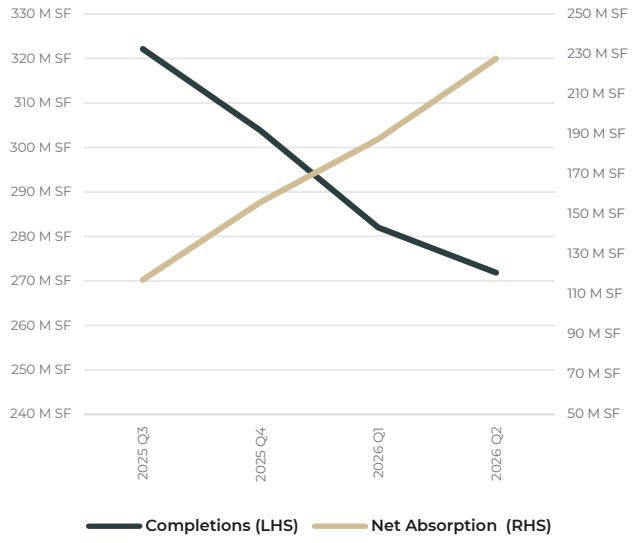
DEVELOPMENT YIELDS & SUPPLY CONSTRAINTS

- With the possibility of further increases in the 10-year Treasury rate and possible higher cap rates, a rates "insurance policy" is needed.
- Development has the potential to be that insurance policy with the potentially to partially offset possible increases in rates.
- The spread between development yields and cap rates can act as an insurance policy against rising rates.
- Development yields today are on average 150 basis points (bps) above cap rates, meaningfully higher than the current cycle low of 50 bps.
- The 150-bps spread provides a margin of safety in the event that cap rates increase.
- Additionally, if short-term interest rates were to increase further pushing up the cost of construction financing, that would be a headwind to construction constraining competitive supply.

TIME

- Development can also be an insurance policy in that it provides time.
- This includes time for the possibility of stronger rent growth and possibly a more favorable interest rate environment.
- Demand for logistics space has increased while completions are down from recent cycle highs, creating potential rent growth acceleration over time if demand outpaces completions.
- If rent growth were to accelerate, depending on how much it accelerates relative to potential cap rate increases, future rent growth could partially offset potential cap rate increases.
- Market-level, building size segment, and building-level analysis will be critical as there will be significant variation in supply, demand dynamics and resulting rent growth.
- Additionally, development provides time for the possibility, not certainty, of a more favorable interest rate environment.
- There are many forces placing upward pressure on interest rates today, and while they may continue, some or one may abate possibly creating a more favorable interest rate environment.
- The alternative is that the forces currently placing upward pressure on rates may intensify.
- The factor having the greatest impact on rates today also has the greatest uncertainty, energy prices.





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