September 12, 2016

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Data Center Properties Create a Powerful Pull

Technology is evolving exponentially. On all fronts—business, consumer, user—the Internet has become a necessity. Whether saving company files to the cloud, shopping on Amazon or streaming Netflix, all this data flows through one commercial real estate property type: data centers. This greater demand for data presents a significant opportunity for investors in data center properties. "Corporate clients in the past five years have migrated quickly from owning data center properties to sale/leaseback, colocation, managed services. They are more focused on third-party solutions (colocation, cloud, managed services), as well as flexibility for these services," says Patrick Lynch, managing director for data center solutions at real estate services firm CBRE. In stepped the REITs, which have largely taken over operation of these facilities. The data center sector alone makes up 5 percent of the overall value of all REITs, according to Lynch. "Specialty REITs (primarily cell towers and data centers) have dominated capital issuance in all forms over the last several quarters and have outpaced the rest of the sector combined year-to-date," according to Fitch Ratings' U.S. Equity REIT Outlook. The data center REITs have experienced accelerated growth this year as a result of rising demand, says Steven Marks, managing director with Fitch. He expects the trend to continue. "Data needs to flow through somewhere," he notes. According to research firm the CoStar Group, in the first two quarters of 2016, investment in data center properties totaled approximately $634.6 million and encompassed 4.4 million sq. ft. of space, compared to $494.6 million in investments sales closed in the first two quarters of 2015 encompassing 5.7 million sq. ft. of space. It appears data center property prices have gone up. For the whole of 2015, the total volume of data center sales nationally was approximately $1.11 billion, and included 10.89 million sq. ft. of space. These specialized properties (consider that a typical facility has a 24 ft. ceiling height, with a 46-in. raised floor to store cooling and electrical wiring) need juice. Electricity consumption measured in megawatts is the metric that primarily defines fundamentals and deal structures in the sector, as opposed to the square footage metric used by the rest of the commercial property types. "In this sector, you can run out of power before you run out of space. Valuations are based on power. Deal is typically structured at kilowatt per month plus utilities," Lynch says. Data centers can be split into two sub-types: wholesale data centers and carrier hotels. The wholesale data centers are akin to "Costcos of data centers," and produce between 100 and 200 watts per sq. ft., according to Lynch. Their total power usage can exceed 100 megawatts and they can be as large as a million square feet in size. Meanwhile, carrier hotels are "small locations for interconnectivity and data hand-offs, primarily in CBD areas." These properties span from 100,000 to 200,000 sq. ft, with the maximum size producing 75 watts per sq. ft. CBRE's outlook for the sector is wholly positive this year, as developers increase construction to answer the unending demand for supply. "Fortune 1000 Enterprise clients continue to expand their IT infrastructure," Lynch says. Investment dollars are mostly going into core data center markets: Northern Virginia (with 4.9 percent vacancy), Silicon Valley (with 7.3 percent vacancy) and Chicago (with 4.3 percent vacancy). "Northern Virginia is competitively priced, has close proximity to undersea cables, low latency connection to Europe, robust connectivity ecosystem and significant regional and global demand," Lynch says. These are key qualities in site selection for this asset class. They are also the qualities that can lead to oversupply in select markets. According to Marks, Northern Virginia and Northern New Jersey are two areas where investors are "most concerned about supply/demand fundamentals, as these markets are prone to overbuilding." First-generation data centers built in the 1990s might require additional redevelopment dollars after they are purchased. Many of these properties are under-powered or inefficient and need to be brought up to speed. In some cases, the buyers may look to expand modularly based on demand if space becomes an issue. Usually, new owners/operators choose to replace equipment, funding the investment from their recurring cash flows, Marks says. Knocking down a data center to build from scratch is "cost-prohibitive," he adds. **(National Real Estate Investor/Diana Bell)**

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Big-Box Warehouse Sector Breaks Records in Demand, New Construction

Modern big-box distribution centers have experienced a massive comeback, with a record number of facilities now under construction nationwide and developers scrambling to repurpose buildings in major markets to appeal to e-commerce tenants. E-commerce has continued to prop up big-box warehouse construction (defined as properties larger than 300,000 sq. ft.). Almost 100 big-box facilities, totaling about 60 million sq. ft., were delivered to the market in the past 12 months, according to a recent report from real estate services firm Colliers International. Only 157 of the 1,908 U.S. big-box facilities are currently empty, and even though another 20 million sq. ft. of new space is delivered each quarter, these properties have only a 7.4 percent vacancy rate. In pace, the pace of big-box warehouse growth is breaking both local and national records, according to James Breeze, national director of industrial research at Colliers and one of the report's authors. "This is happening because of the incredibly fast shift in demand for e-commerce; this has never happened before in the supply chain," he says. "Absorption continues to outpace new construction, and while some retailers are starting to be able to compete with Amazon, there are others that are just getting started on their e-commerce strategies. Companies are becoming more adept, and investment is shifting away from stores to the distribution centers." Retailers, even those who have embraced online sales strategies, have struggled to compete with e-commerce players. For example, Macy's, which had altered its supply chain to set up min-warehouses at its stores, announced last month that it will close another 100 stores. Even though e-commerce makes up only about 10 percent of all U.S. sales, online transactions are growing at five times the pace of those at brick-and-mortar properties, Breeze says. Amazon is still far outselling the top U.S. retailers online, and has posted annual growth of more than 30 percent, along with a continued effort to occupy big-box space. The company recently announced it will open an 850,000-sq.-ft. fulfillment center in Monee, Ill. Earlier this year, Amazon leased 767,161 sq. ft. in Romeoville, Ill., more than 1 million sq. ft. in Forth Worth, Texas, 810,000 sq. ft. in Carteret, N.J. and 2.1 million sq. ft. in two buildings in San Bernardino and Eastvale, Calif. The growth in big-box warehouse leasing doubled construction efforts from 2009 to 2015, especially for speculative properties, according to Colliers. Dallas-based Hillwood, the real estate arm of the Perot companies, announced Tuesday that it has purchased 85 acres in Joliet, Ill. to build a 1-million-sq.-ft. spec distribution center. "This property is one of eight 1-million-sq.-ft. distribution centers developed over the past 18 months," said Don Schoenheider, senior vice president for the company, in a statement. Hillwood's new property will include features that the new e-commerce customer requires, Schoenheider notes, including 36-foot clear heights and enough parking for more than 500 employee vehicles. E-commerce clients are demanding such amenities for their leases, as well as more perks for their employees, including larger break rooms and restrooms, Breeze says. "E-commerce properties are more labor-intensive than the former distribution center crews, and that's pushing some of the new construction," Breeze says. "Everybody's trying to catch up, to compete for the demand that's out there, and investors are shifting capital into the new e-commerce requirements." **(National Real Estate Investor/Robert Carr)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.84	.82	.33
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	1.67	1.51	2.21
30 YEAR TREASURY	2.39	2.23	2.98