

The Bulletin

Data Center: A Hotspot for REIT Investors!

**AUTHOR**

Maxence Guérin
Analyst

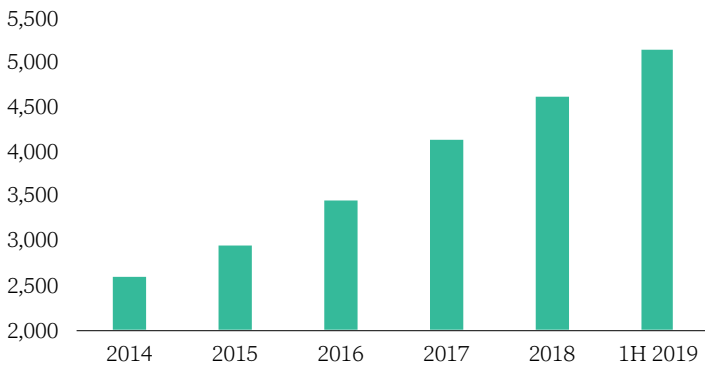
Maxence Guérin is an analyst at Presima, a specialist boutique focused exclusively on global real estate securities.

Our data usage has exploded in recent years. Whether it's emails and their attachments, Facebook stories and Instagram photos, or daily medical and sports data on our favorite health apps; our personal and professional lives are more than ever interconnected with data. All this data is stored in thousands of data centers and made available at our immediate request. Wouldn't it be nice to invest in this expanding niche sector that has been supported by the booming cloud business¹?

NOW YOU CAN:

Data center REITs offer unparalleled access to this exceptional growth opportunity.

Top 12 US Markets Inventory (MegaWatts)

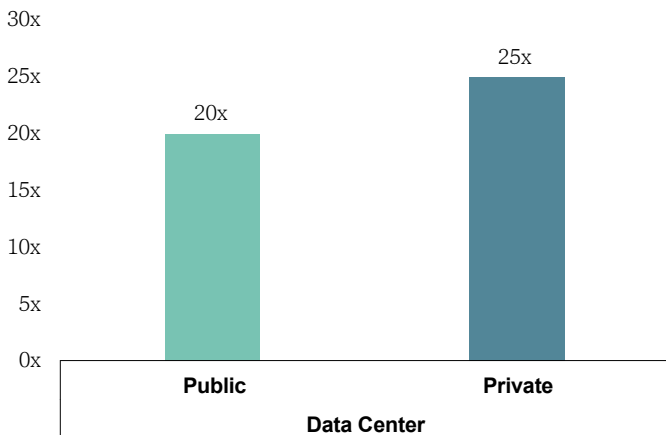


Source: 2020 Outlook, The Could Has Four Walls, Credit Suisse, Equity Research, Americas, December 19, 2019.

PRIVATE VS PUBLIC

One way to gain access to this asset class is through a data center REIT, which is essentially a real estate company specialized in data centers and with a focus on building a network of connected campuses and internet gateways. Publicly traded data center operators (or data center REITs) currently have a position of strength over most privately held companies as they have global scale, key locations, younger facilities and better power distribution capabilities. But what we at Presima like most, is that they compare favourably versus the direct market in terms of valuations, as depicted in the chart below.

Valuation Disconnect between Private and Public (EV/EBITDA)



Source: Sami Badri, Credit Suisse, CAPRE Atlanta Conference, August 15, 2019.

Over the last several years, the sector has attracted many institutional and private equity investors which has pushed up values and compressed cap rates at a faster rate than other sectors. Currently, buyers are willing to pay ~5% cap rates in primary markets². Driving IRRs further for listed data center results is an abundant access to debt (in some markets at a sub-1% rate³) and development opportunities with 9%-12% stabilized yields⁴. We see significant value being created and unlocked through development, asset sales and capital redeployment.

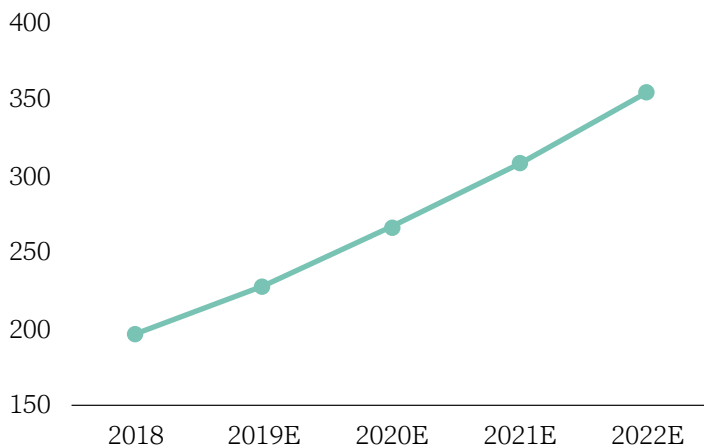
THE IMPORTANCE OF SCALE

Global data center providers have a clear advantage over local data center providers as large multinational corporations (the tenants) seek complete turnkey solutions for their needs.

The strategic benefit of being global is also beneficial when negotiating space with large tenants as they value connectivity, scale and speed of deployment. As an example, Century link, a global communication provider which operates in 60 countries, chose Digital Realty as its business partner and landlord in 82 different locations⁵. Large social media companies and cloud service providers are no different in their approach which is why the value of the data center “network” is greater than the sum of its parts.

In fact, the largest tenants of data centers are high-growth technology companies which can be broken into the following groups: i) cloud service providers (Amazon, Microsoft, Google, etc.), ii) information technology service providers (IBM, Oracle, etc.) and iii) network providers (Verizon, CenturyLink). The non-IT exception that is well represented consists of financial institutions (JP Morgan Chase, Morgan Stanley, etc.) as they need a secure and uninterrupted environment for their own clients⁶.

Worldwide Public Cloud Service Revenue Forecast (Billions of US\$)

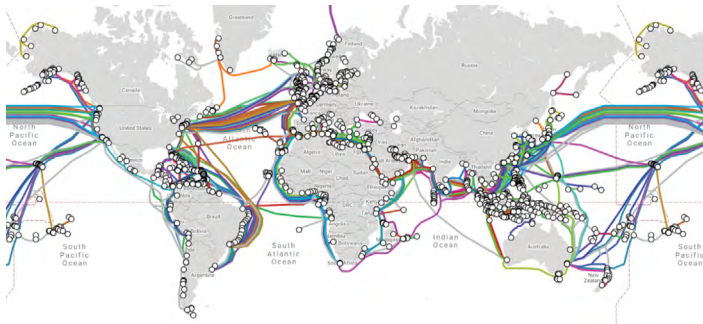


Source: “Gartner Forecasts Worldwide Public Cloud Revenue to Grow 17% in 2020.” Gartner, www.gartner.com

LOCATION, LOCATION, LOCATION?

As is the case for all real estate, location is also key for data centers. Although one might think that setting up a data center in a remote area or in a low-cost power environment might be the most highly valued idea, customers have significantly more complex criteria than pure cost reduction. They also look at the improved application performance, the speed of deployment of new data center space, the ability to directly connect with cloud service providers or undersea cable, and geographic proximity to end users. Consequently, the most significant markets in the world by size are currently Northern Virginia, London, Tokyo, Beijing and Silicon Valley. These markets all have a large local population, a strong business sector, robust fiber and available power⁷.

Undersea Cable Locations that are Critical for the Internet



Source: submarinecablemap.com

CONTINUED GROWTH ON THE HORIZON

We view the sector favourably for several reasons. First, we believe the strong secular demand trend will continue. Second, there is a significant opportunity for value-add returns through accretive developments. Lastly, the sector's high barriers to entry and the institutionalization of the asset class, which is still in the early innings, should continue to favour data center REITs.

Still not convinced? Consider the following⁸:

- Artificial intelligence is set to grow by 45% annually between 2016 and 2025;
- The use of the Internet of Things (IoT) should reach 20.4 billion IoT units installed this year;
- Autonomous vehicles are expected to quadruple within the next 5 years and
- Virtual and augmented reality could reach a market size of \$193 billion by 2022.

All these new technologies will be highly integrated into our lives. And, to ensure the best user experience, we believe that these technologies will have to rely on the robust infrastructure offered by global data center providers, not the private local and regional players. Listed data center REITs are currently market leaders in this respect and are well positioned to capture this future growth.

While we acknowledge the risk that technological advances could change the growth trajectory of demand for data centers, we currently forecast that demand will continue to outpace technology for the foreseeable future.

There are great opportunities in this complex but growing sector, and we believe that listed data center REITs have a leg up on their peers. Thanks to their successful experience building global networks, they offer investors an exposure that is greatly difficult to replicate for direct or local players.



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CONTACT

Amina Si Chaib,
Senior Associate,
Client Service & Marketing
asichaib@presima.com
(514) 673-1224