

Digital real estate stability through a turbulent market

A roundtable discussion with TA Realty's data center team

What attracted TA Realty to the data center asset class, and where do you see the opportunities going forward?

Allison O'Rourke: We've been diligently monitoring the evolution of the data center industry for a long time and, in early 2021, made our first investments in the sector. As a real estate play, data center assets are fundamental to global economic growth. Having the right piece of property with the right power and the right connectivity is key. These assets will have lasting value and will be a driving force in the expansion of the digital economy. As a society, we are only at the beginning stages of being able to capture and use data to improve our lives. The evolution to having more – and improved – actionable data at our fingertips requires data centers to play a central role, and we believe this is a very compelling investment opportunity.

David Buxbaum: TA Realty is focusing primarily on the large hyperscale users in the data center space, whether it be by investing in existing powered shell or turnkey assets that house these users or the development of either of these building types on an individual or campus setting. We also see opportunities for edge facilities with these same users, which we define as infill solutions targeting latency and interconnection needs for high-speed compute functions near major population centers.

Tim Shaheen: Due to the “pull” toward the end user, hyperscalers need to deploy in metros closer to their users and, as a result, are stretching the limits of the current utility infrastructure in mature markets. The power constraints and available land that is zoned and permitted appropriately, coupled with end-user customers requiring proximity, are expected to drive new growth in submarkets of established primary locations, as well as secondary markets with robust power infrastructure and favorable economic incentives. In addition, the continuous need for data storage will drive new developments across the globe, and the self-perform model historically used by hyperscalers is no longer sufficient.

How do you see the data center market evolving in the United States?

Shaheen: Historically, a handful of operators were able to control the development market outside of hyperscale self-building, but buying habits have changed. A five-megawatt [MW] deployment used to be considered in the upper echelon of deal sizes, but hyperscalers are now

buying in much larger portions – 20MW, 30MW, 50MW to 100MW or greater. Traditional data center operators were used for much smaller deployment strategies, which have been coupled with excessive overhead to create a “moat” through services provided within a facility and excessive capital expenditures to bring these services to life. This has created an opportunity for more flexible capital to enter the space, with pure real estate DNA and without the premium pricing associated with “bells and whistles.” This alternative for hyperscalers provides exactly what they desire from a cost and capital standpoint. On top of these considerations, municipalities are becoming increasingly intelligent as it relates to how data centers are deploying in their markets. While they originally enjoyed the tax revenue windfall created by development, they are also now forced to develop and provide power in vast quantities, with large portions allocated for data centers.

O'Rourke: Several markets have struggled to supply the power needed to accommodate requirements from hyperscale users. These delays have pushed new project schedules out and changed the planning cycles. This dynamic is a major shift from the just-in-time delivery approach that the sector was used to, and it is having an impact on location choices. Demand in Northern Virginia is flowing into other top markets like Dallas and Phoenix, and we see increased demand in what previously would have been considered secondary or tertiary markets.

The U.S. data center market has seen several exceptionally strong years. Do you see that outperformance continuing?

Lisa Strobe: While 2022 set new performance records for the data center market, 2023 is anticipated to be even stronger. Demand reached new highs in 2022, while many primary markets struggled to deliver the power needed to accommodate requirements from large users, creating a backlog of requirements and opportunities for markets historically not accustomed to demand growth. Vacancy rates across the top markets fell to all-time lows heading into 2023. Less than 1 percent of Northern Virginia's market is vacant, and new development pipelines are largely preleased. With fewer options for enterprise and hyperscale users in the market, data center rental rates have increased. Early indicators for pricing suggest asking rents increased to the mid-to-high single-digit range on average in 2022, and they are expected to continue to rise in 2023 [DataCenterHawk, fourth quarter 2022].

Is data center demand being affected by the slowdown the tech sector has experienced recently?

Buxbaum: Despite the headlines by many of the largest users of data center space, these companies continue to invest heavily in data center solutions. Even with an uncertain economic outlook heading into 2023, data centers have become a critical part of society's infrastructure and are expected to continue to grow in importance, even as the sector is navigating a more complex environment.

O'Rourke: The tight data center fundamentals reflect the anticipated durability of the sector across economic cycles. As storing and processing data has become increasingly critical to our economy, large tech companies and hyperscalers are being forced to shift their buying strategies to a longer-term perspective. These longer-term strategies are pushing the deployment sizing higher and making available land, power, networks and connectivity increasingly challenging to come by in mature ecosystems and regions. Mature markets with established ecosystems are expected to continue to experience significant growth, but the need for alternative regions and sites with the requisite power and economic incentives is growing.

What do you think the catalyst for growth will be in 2023 and beyond?

Strope: Data has been one of the fastest-growing commodities in the world, and it is showing no signs of

slowing down. Global enterprise cloud spending is expected to grow by more than 20 percent and reach \$600 billion in 2023. This would be a faster rate of growth than the 18 percent growth seen in 2022 [Gartner, October 2022]. Cloud migration is expected to continue to drive hyperscale data center deployment, as the industry is rapidly shifting from enterprises owning and operating their own data centers to outsourcing that function to public cloud providers and colocation operators. Further, the recent emergence of machine learning and artificial intelligence has opened the door for new computing needs.

Shaheen: Artificial intelligence [AI] applications are both latency and non-latency sensitive and require never-before-seen densities – 50 kilowatts to 100 kilowatts or more per rack. These factors will likely require changes in facility design – how they are built – and the densities needed will affect location – where they are built. AI is expected to decentralize the data center landscape, driving development in new markets with access to plentiful utility and renewable power that are not necessarily required to reside within an existing ecosystem. Further, the growth of federal data being outsourced to the four major cloud providers will result in multibillion-dollar opportunities and will require new infrastructure built to the specifications of the federal government for classified applications.

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CORPORATE OVERVIEW

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