

Data Center Real Estate Still Surging



At the start of 2023, McKinsey released a report detailing the rapid surge in demand for data center real estate. They also projected that the industry would grow by around 10% per year through 2030.

Since then, we've seen the industry continue to go from strength to strength, with some experts even stating that the forecast may be low and that we should expect an even steeper growth trajectory.

Whichever of those predictions you believe, the overall upward trend is clear. Evidence from indicators like construction, leasing, and investment activity all support an outlook of sustained growth and continued demand for data center real estate in the coming years.

Scaling Up

One of the key trends we've seen is a dramatic increase in data center construction that shows no signs of declining. In fact, data from the June 2024 Dodge Momentum Index (a leading indicator of construction activity) shows that data centers "continued to dominate planning projects in June," contributing significantly to a 14.5% surge in commercial planning. Dodge lists several massive data center projects as leaders of construction activity, including a \$420 million project in Leesburg, Virginia.

Those developments build on the trend of massive new data facilities (aka hyperscale data centers) springing up across the globe, with data from Statista showing nearly 300 new facilities built in the last two years alone. A large majority of those hyperscale developments (39%) have been built in the US, followed by developments in China and Japan.

Data Center Hot Spots

Within the US, certain states are emerging as hot spots for new data center projects. Northern Virginia and Northern California, for example, have seen several massive new projects, as tech giants like Microsoft and Amazon rush to meet growing demand for artificial intelligence (AI) and cloud services.

Other hot spot states include Illinois, New York, and Texas, with the latter slated to house a \$1.3 billion Amazon prime data center on a 206-acre parcel of land near Austin.

Data Center Real Estate Still Surging

Data REITs on the Rise

Naturally, demand for data centers has prompted growing interest in the asset class amongst investors, accompanied by a rise in the number of data centers being included in investment instruments like REITs (Real Estate Investment Trusts).

According to REIT trade association Nareit: “As of the first quarter of 2024 (the latest data available), data centers accounted for 11.5% of aggregate assets under management; the sector’s weight in the FTSE Nareit All Equity Index was 9.3%. This overweight highlights active REIT managers’ bullishness on data centers.”

The sector is supported by strong fundamentals. On average, net operating income (NOI) from data centers has experienced a 4.2% year-over-year gain, a figure that Nareit notes: “more than amply kept pace with inflation.”

Leasing Surge

Data center leasing numbers have also been on the increase. Globally, data center leasing activity “hit a record in 2023, reaching approximately 4,300 MW” (megawatts (MW) rather than square feet are used as the principal size measurement for the sector).

That trend has continued in 2024, with 1,800 MW of new leasing deals — 80% of which were in the US. Nareit adds: “Current sector vacancy remains limited and new project deliveries tend to be slow,” which means we should expect to see continued rent growth in the future.

Tapping Into the Data Center Trend

For commercial real estate (CRE) professionals, the growth of this sector presents some interesting opportunities. The most obvious of these are in direct dealmaking - connecting tenants with colocation facilities, or meeting the growing demand for smaller, localized data centers that support edge computing applications.

Other opportunities are more tangential — sitting in the intersection between data centers and the infrastructure and support systems needed to keep them operating smoothly.

In their 2023 report, McKinsey noted that the power demands of the data center sector are likely to create a lot of opportunities for sustainable energy providers, especially as those demands continue to increase year-on-year. In many cases, hyperscalers like Google have started funding renewable energy plants, boosting the expansion of existing facilities as well as the construction of new ones.

Other associated trends, like the manufacture of prefab and modular data center components, create opportunities in the industrial and logistics sectors, or the associated multifamily housing needed to support the workforce underlying these projects.

For savvy CRE professionals, these developments provide a wealth of potential deals. The key to succeeding in this context lies in anticipating new needs and capitalizing on these new opportunities as they arise.