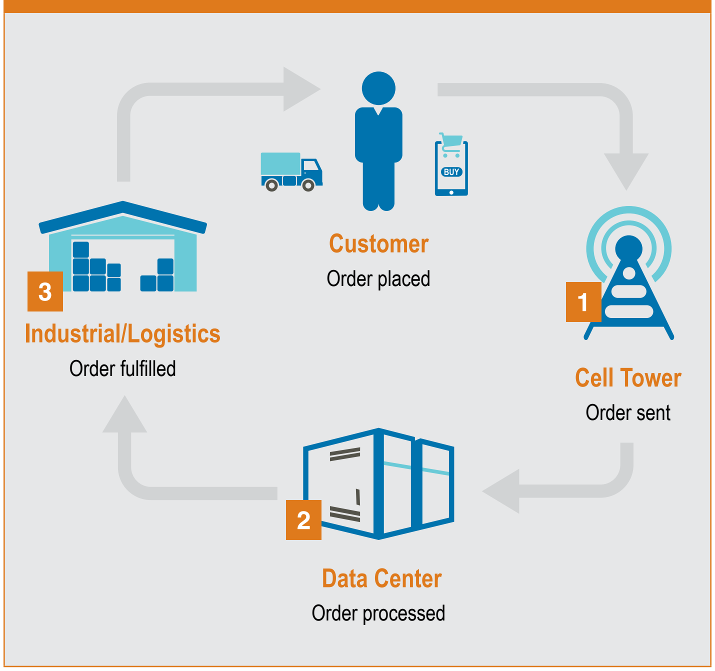
Three REIT Sectors Vital to the E-commerce Ecosystem

While much of the market's recent focus has been on how e-commerce is challenging retail landlords, one should not overlook the fact that an even larger segment of the U.S. REIT market stands to benefit. We profile three sectors—cell towers, data centers and industrial properties—that lie at the heart of the digital ecosystem, providing critical infrastructure for the e-commerce value chain.

Every time you make a purchase on your smartphone or computer, it sets a sequence in motion that travels through a network of communications, data and logistics facilities—many of which are owned by real estate investment trusts (REITs). These companies play an integral role in getting your package from the warehouse to your doorstep, giving investors a way to participate in the potential growth of e-commerce.

The E-commerce Value Chain



1: Cell Towers

Tower companies have been taking increasing advantage of the REIT structure in recent years, with several prominent REIT conversions. Their "real estate" generally consists of steel towers (sometimes disguised to look like trees) or rooftop structures, as well as the ground space below. A single tower can typically accommodate multiple tenants, leasing the vertical space to wireless and broadband service providers.

REIT examples

- American Tower—converted to a REIT in 2012, surpassing Simon Property Group as the world's largest REIT by market capitalization
- Crown Castle International—converted to a REIT in 2014, with roughly 40,000 towers across the U.S.
- SBA Communications—the oldest tower company, filed as a REIT for the first time in 2016

Tenants

- Wireless carriers—Verizon, AT&T, Sprint, T-Mobile, NTT docomo, Softbank
- Government agencies—police, emergency medical services
- Broadband data providers/cable companies

Typical growth drivers. Wireless carriers need to continuously improve their networks due to the explosive growth in mobile data use. These investments typically translate into new tenants for towers and/or amendments of existing leases.

Lease structure. Contracts typically last 5–10 years and have historically had a 98–99% renewal rate upon expiration, resulting in highly predictable cash flows. Leases often include annual escalators, with rents increasing automatically by 3% to 3.5% in the U.S., or linked to inflation elsewhere.

Supply cycle. Because towers are relatively simple structures, they can be built quickly to meet rising demand. As a group, companies have recently been constructing several thousands of towers a year. However, incumbent tower owners generally enjoy significant barriers to new competition due to strict zoning laws, limited suitable locations and the network effect and scale their towers provide to end users.

2: Data Centers

Whether serving up video from the cloud, routing an online transaction, or connecting employees through virtual networks, data centers provide critical support for the digital economy. A data center might look like a normal office or industrial building from the outside. But once you pass through their heavily secured entrances, the insides are a hive of optical cables, equipment racks, cooling units and backup generators, where businesses can rent space to store networking, data storage and communications hardware. With thousands of companies housing equipment in the same space, businesses can easily connect to different partners and service providers to deliver content to users.

REIT examples

- CyrusOne—a relatively new REIT (founded in 2012), with more than 30 data centers worldwide
- Digital Realty—owns 156 data centers in 32 global markets and is one of the largest U.S. REITs
- Equinix—the largest data center REIT, focused on connecting business to their technology partners

Tenants

- Cloud services—Amazon, IBM, Microsoft, Oracle
- Internet—eBay, Facebook, Google, Netflix
- Financial services—JPMorgan, Morgan Stanley
- Communications—AT&T, CenturyLink, NTT Communications

Typical growth drivers

- Accelerating adoption of cloud computing, e-commerce and digital media
- Growing need for data storage and computing power
- Outsourcing of IT infrastructure
- Business continuity/disaster recovery planning

Lease structure. Data centers consume massive amounts of power and rents are generally based on how much electricity a tenant needs rather than square footage. Leases for larger wholesale tenants often last 7 to 10 years, while smaller retail tenants usually have shorter leases of less than 5 years. Historically, high customer retention rates have generally resulted in stable cash flows, and contracts usually contain yearly rent increases tied to inflation.

Supply cycle. A data center shell structure can be built in less than a year, but the complex infrastructure inside the center—such as generators, coolers and raised flooring—can require substantial upfront capital. New development has been a key avenue for growth in data center REITs.

The Internet in 2020

2,300,000,000,000,000,000,000

Bytes of global internet traffic per year—nearly as many as there are stars in the universe

5 million years

How long it would take to watch all the video crossing the Internet in a single month

3:1

Ratio of Internet-connected devices to global population

4.6X

Increase in peak-hour traffic from 2015 to 2020, compared with 2X for overall traffic—which should require greater bandwidth and server capacity

82%

Video content as a percentage of total consumer Internet traffic

61X

Increase in virtual reality traffic from 2015 to 2020

Source: Cisco VNI: The Zettabyte Era, June 2, 2016.

Industrial REITs own warehouses that are generally used by retailers and logistics companies to house goods that are ultimately delivered to a store or directly to the end consumer. Historically, these properties have been located near transportation hubs such as airports, marine ports and highways. But the growth in e-commerce is structurally changing traditional logistics for parcel delivery. Industrial landlords are now building facilities closer to population centers where consumers and workers live, allowing businesses to deliver goods to consumers faster and cheaper. Many warehouses are becoming increasingly automated with robots that work alongside human operators to store and retrieve items.

REIT examples

- Prologis—the largest REIT in the industrial sector, based in the U.S. but with sizable footprints in Europe and Asia
- Duke Realty—recently shifted its business strategy to focus on industrial properties, with relatively young assets

Tenants

- Online retailers—Amazon (currently the largest user of industrial real estate)
- Third-party logistics—FedEx, Nippon Express, UPS
- Traditional retail—Walmart, Pepsi, Home Depot
- Manufacturing

Typical growth drivers

- Personal consumption via e-commerce and brick & mortar stores
- Modernization of supply chains to support improved logistics efficiency
- Air and port container volume (global trade)
- Growth of the middle class in emerging markets

Lease structure. Lease terms are getting shorter, generally ranging from 5 to 15 years for traditional, large out-of-town warehouse properties to 2 to 5 years for closer-in locations where demand is strongest.

Supply cycle. Industrial properties have short construction times due to less-complex building requirements, so supply tends to track demand more closely than for complex property types such as hotels or offices. Amid the rise in e-commerce, more construction has been occurring near densely populated areas to help meet faster delivery times demanded by online purchasers.

Unique Opportunities Present Unique Challenges

Technology-related REITs offer some of the more attractive opportunities we see today, benefiting from the rise of e-commerce and the demand for faster mobile networks, faster delivery times, more bandwidth and more data storage. These powerful secular drivers tend to be less dependent on the broader economy, which may help to counter the ebbs and flows of market cycles.

However, there are unique challenges to investing in these property sectors, as they participate in a market that is still rapidly evolving. With consumers spending more online and organizations modernizing their operations, there seems little doubt that the e-commerce marketplace should continue to grow in size and sophistication, progressing in ways that have not even surfaced yet.

The analysis this will require should not be considered lightly, in our view, underscoring the importance of fundamental research—the cornerstone of the active management process. With over 30 years of REIT investing experience, Cohen & Steers has built the world's largest investment team dedicated to real estate securities, giving us a unique perspective on the market. Historically, this knowledge advantage has given us an edge when managing REIT portfolios, allowing us to deliver consistently superior results for our investors over multiple time periods.

We expect increased spending on e-commerce infrastructure will continue to drive tremendous growth for certain REITs, requiring a deep understanding of this rapidly evolving marketplace.

COHEN & STEERS
REAL ASSETS. REAL RETURNS.

Cohen & Steers

REAL ESTATE • The Original Real Asset

Important Disclosures

Data quoted represents past performance, which is no guarantee of future results. The information presented above does not reflect the performance of any fund or account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. There is no guarantee that any historical trend illustrated herein will be repeated in the future, and there is no way to predict precisely when such a trend will begin. There is no guarantee that any market forecast made in this commentary will be realized. The mention of specific securities is not a recommendation or solicitation for any person to buy, sell or hold any particular security and should not be relied upon as investment advice. The views and opinions in the preceding commentary are as of the date of publication and are subject to change without notice. This material represents an assessment of the market environment at a specific point in time, should not be relied upon as investment advice, is not intended to predict or depict performance of any investment and does not constitute a recommendation or an offer for a particular security. We consider the information in this presentation to be accurate, but we do not represent that it is complete or should be relied upon as the sole source of suitability for investment.

Please consider the investment objectives, risks, charges and expenses of any Cohen & Steers U.S.-registered open-end fund carefully before investing. A summary prospectus or prospectus containing this and other information may be obtained by visiting cohenandsteers.com or by calling 800 330 7348. Please read the summary prospectus or prospectus carefully before investing.

Risks of Investing in Real Estate Securities. The risks of investing in real estate securities are similar to those associated with direct investments in real estate, including falling property values due to increasing vacancies or declining rents resulting from economic, legal, political or technological developments, lack of liquidity, limited diversification and sensitivity to certain economic factors such as interest rate changes and market recessions.

This commentary must be accompanied by the most recent Cohen & Steers fund fact sheet(s) and summary prospectus if used in connection with the sale of mutual fund shares.

Cohen & Steers Capital Management, Inc. (Cohen & Steers) is a registered investment advisory firm that provides investment management services to corporate retirement, public and union retirement plans, endowments, foundations and mutual funds.

Cohen & Steers U.S.-registered open-end funds are distributed by Cohen & Steers Securities, LLC, and are available only to U.S. residents.

Cohen & Steers UK Limited is authorized and regulated by the Financial Conduct Authority (FRN 458459). Cohen & Steers Japan, LLC, is a registered financial instruments operator (investment advisory and agency business with the Financial Services Agency of Japan and the Kanto Local Finance Bureau No. 2857) and is a member of the Japan Investment Advisers Association.

About Cohen & Steers

Cohen & Steers is a global investment manager specializing in liquid real assets, including real estate securities, listed infrastructure, commodities and natural resource equities, as well as preferred securities and other income solutions. Founded in 1986, the firm is headquartered in New York City, with offices in London, Hong Kong, Tokyo and Seattle.