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.

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.

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.

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

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.
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.
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