

SECTOR UPDATE

REITs – Singapore

Data Centre REITs: Backfilling Supported By Tight Vacancies

Asking rents across primary wholesale colocation markets increased 14.5% in 2022, the first increase in five years. Northern Virginia and Silicon Valley are constrained by shortage of power and vacancies, reaching a low of 0.98% and 2.3% respectively. Rising rents and tightening vacancies augur well for DCREIT and MINT's efforts to backfill potential vacant data centre space. Our preferred BUY is DCREIT (Target: US\$0.78), followed by MINT (Target: S\$2.79). Maintain OVERWEIGHT.

WHAT'S NEW

- **First year of positive growth in rents since 2017.** According to CBRE Group (CBRE), asking rents across primary wholesale colocation markets increased 14.5% to US\$137.90/kW/month in 2022. The nationwide vacancy rate for primary markets hit a record low of 3.2%. Northern Virginia and Silicon Valley recorded net absorption of 436.9MW and 62.4MW respectively, bringing vacancies to a low of 0.98% and 2.3%. Rents are expected to maintain an upward trend in 1H23 due to power constraint from supporting expedited developments. CBRE expects demand from hyperscalers to outpace supply, which creates a rent premium for available space.
- **Supply of electricity becomes a bottleneck.** There is a shortage of power and land, especially in Northern Virginia and Silicon Valley:
 - a) Dominion Energy, the largest supplier of electricity in Northern Virginia, warned that it could not meet the demand for electricity from data centre hub Loudoun County. The problem lies with the transmission of electricity via overhead power lines. New data centre developments face delays in delivery and reduced allocation of electricity till 2026.
 - b) The state of California faces shortage of electricity as coal-fired power plants and nuclear generators are being retired more quickly than can be replaced by renewable energy and battery storage. Power transmission through overhead power lines is often disrupted by wildfires. Prolonged drought has also limited the production of hydroelectric power. In Silicon Valley, Pacific Gas & Electric and Silicon Valley Power are capacity-constrained and the next upgrade for the grid is only scheduled in 2025. Electric utilities are allocating more resources to reduce the risk of power lines causing wildfires and placing less emphasis on new business and capacity expansion over the next five years (2023-27). According to CBRE, transmission substation sites cannot be energised till 2028/29.
- **Expansion in secondary markets.** Hyperscalers are expanding in secondary markets with cheaper land, greater power supply and favourable tax incentives, such as Salt Lake City and Omaha. Secondary markets with ample supply of renewable energy, such as Hillsboro and Montreal, are also well sought after.
- **Demand for cloud computing continues to grow.** Demand for data centres is supported by growth in internet traffic, which doubles every four years. Amazon Web Services grew revenue by 20% yoy and generated operating profit of US\$5.2b in 4Q22. Similarly, Microsoft's cloud business grew revenue by 22% yoy with an attractive gross margin of 72%. Microsoft also disclosed that over 200 customers have signed up for Azure OpenAI Service. Cloud computing is capturing a larger share of IT spending. There is a resurgence of enterprise demand as companies shift towards hybrid cloud.

PEER COMPARISON - DATA CENTRE REITs

Name	Ticker	Rec	Curr	Price 21 Mar 23	Target Price	Mkt Cap (US\$m)	Hist	Curr	Yield (%) Fwd 1y	Fwd 2y	Debt to Equity (%)	Debt to Assets (%)	P/NAV (x)
Digi Core REIT USD	DCREIT SP	BUY	US\$	0.435	0.78	489	9.1	8.8	9.3	9.5	53.5	34.0	0.53
Keppel DC REIT	KDCREIT SP	NR	S\$	2.04	n.a.	2,623	5.0	5.1	5.3	5.7	60.7	36.4	1.45
Mapletree Ind Trust	MINT SP	BUY	S\$	2.33	2.79	4,770	5.9	5.8	5.8	5.8	55.2	37.2	1.23

Source: Bloomberg, UOB Kay Hian

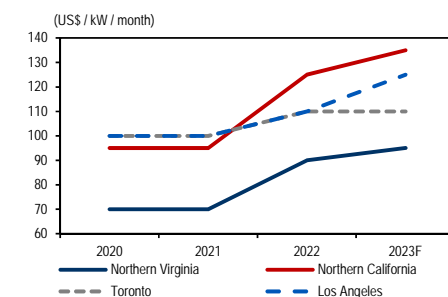
OVERWEIGHT (Maintained)

SECTOR PICKS

Company	Rec	Share Price (lcy)	Target Price (lcy)
DCREIT (US\$)	BUY	0.435	0.78
MINT	BUY	2.33	2.79

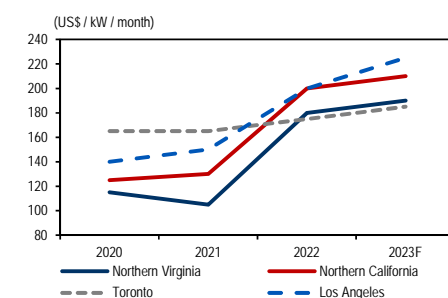
Source: UOB Kay Hian

AVERAGE ASKING RENTS – HYPERSCALE



Source: datacenterHawk

AVERAGE ASKING RENTS – WHOLESALE



Source: datacenterHawk

ANALYST(S)

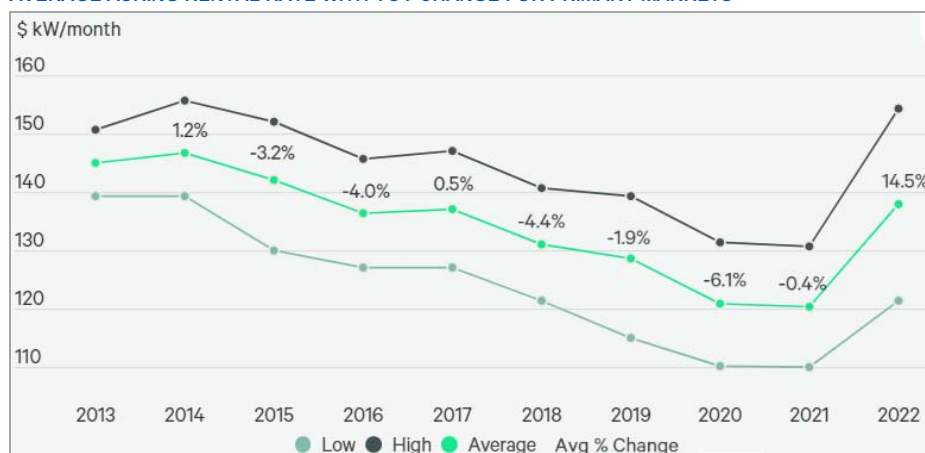
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- AI provides catalyst for future growth.** Being computationally intensive, artificial intelligence (AI) has the potential to boost demand for data centre space. Microsoft and Google will be incorporating generative AI technology into their search engines. Baidu has also unveiled its AI-powered chatbot Ernie Bot in Mar 23 and plans to integrate it into its search engine. Generative AI technology is able to boost the productivity of workers in the creative industries. It creates tools that suggest new ideas and speed up creative production with humans editing the output and providing the final checks.
- Case study: Co-pilot.** Microsoft has incorporated OpenAI's technology to build Co-pilot, an AI system for writing software codes. Co-pilot improves the productivity of software developers by suggesting new codes and providing technical recommendations. It is able to understand the algorithm and advice on testing required. Co-pilot helps software companies improve efficiency and cope with the shortage of engineering talent.

ACTION

- Rents on the rise in core markets.** Rising rents and tightening vacancies augur well for DCREIT and MINT's efforts to backfill potential vacant data centre space. According to dataHawk, rents for hyperscale markets are expected to increase 6% in Northern Virginia, 8% in Northern California and 14% in Los Angeles in 2023. Rents for wholesale markets are expected to increase 6% in Northern Virginia, 5% in Northern California and 13% in Los Angeles.

AVERAGE ASKING RENTAL RATE WITH YOY CHANGE FOR PRIMARY MARKETS

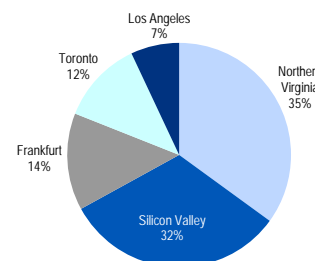


Source: CBRE

DIGITAL CORE REIT (DCREIT SP/BUY/US\$0.435/Target: US\$0.78)

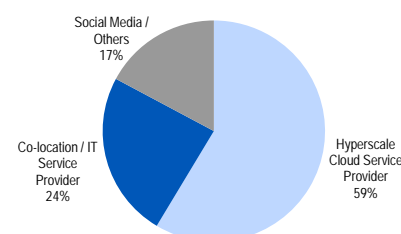
- Potential negative impact should Cyxtera file for chapter 11 bankruptcy protection.** Cyxtera, DCREIT's second-largest tenant accounting for 22.6% of annualised rent, was downgraded by Moody's from B3 to Caa2 on 17 Feb 23. The exposure to Cyxtera is straddled across six data centres. Our sensitivity analysis indicates that FY25 DPU and our target price could drop by up to 29% and 27% respectively in the event that Cyxtera files for chapter 11 bankruptcy protection. Our base case scenario, which assumes DCREIT backfills half of the vacant data centre space, provides FY25 DPU forecast of 3.5 US cents and target price of US\$0.67.
- Revolving credit facility was extended.** Cyxtera has entered into an agreement with all of its revolving lenders to extend the maturity of its US\$120m revolving credit facility from 1 Nov 23 to 2 Apr 24. It is also working to address long-term debt that matures in May 24. Cyxtera remains current on its rental obligations and has not requested any rent deferments, rental reductions, or contraction of the space it occupies.
- A silver lining.** Non-investment grade tenants accounted for 32% of annualised rents (Cyxtera Technologies: 24.1% and Sungard Availability Services: 7.3%) as of Jun 22. DCREIT would have the opportunity to rebalance its tenant base toward investment grade tenants in the event that Cyxtera files for chapter 11 bankruptcy protection.

RENTAL INCOME BY CORE MARKET (DEC 22)



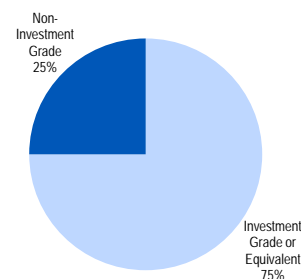
Source: DCREIT

CUSTOMER PROFILE BY TRADE SECTOR (DEC 22)



Source: DCREIT

CUSTOMER PROFILE BY CREDIT QUALITY (DEC 22)



Source: DCREIT

MAPLETREE INDUSTRIAL TRUST (MINT SP/BUY/\$2.33/Target: \$2.79)

- **Risk of non-renewal for four data centres.** Tenants AT&T and Atos could vacate from four US data centres, which account for 15.3% of MINT's total data centre NLA. Two of the data centres at Brentwood, Tennessee (expiry: Nov 23) and San Diego, California (expiry: Dec 24) are fairly large. Our sensitivity analysis indicates that FY26 DPU and our target price could drop by up to 8.9% and 8.6% respectively. Our base case scenario, which assumes MINT backfills half of the vacant data centre space, provide FY26 DPU forecast of 14.0 S cents and target price of \$2.79.
- **Singapore portfolio continues to outperform.** Occupancy for the Singapore portfolio edged higher by 0.1ppt qoq to 96.9% in 3QFY23, driven by flatted factories in Singapore (+1.3ppt qoq to 98.0%). MINT achieved positive rental reversion for its hi-tech buildings (+8.8%) and flatted factories (+9.4%). Gross rental rate for the Singapore portfolio edged slightly higher by 0.9% yoy to S\$2.15psf/month in 3QFY23. Retention rate was high at 92.2%.
- **Redevelopment of Kolam Ayer 2 Cluster.** Based on our channel check, MINT has secured Biotronik as anchor tenant for its seven-storey built-to-suit facility at 165 Kallang Way. 165 Kallang Way obtained its Temporary Occupation Permit on 10 Nov 22. 161 and 163 Kallang Way are expected to be completed in 1H23. MINT has pre-leased two floors of 163 Kallang Way. In total, 39% of 161, 163 and 165 Kallang Way (previously known as Kolam Ayer 2 Cluster) is pre-committed. MINT has achieved attractive signing rents at high-S\$3psf/month.

DATA CENTRES

Property	City	State	NLA (sf)	Valuation (US\$M)	Tenant	Gross Revenue (US\$M)	Lease Expiry
5000 Bowen	Arlington	Texas	90,689	26.2	Atos	3.7	Mar 23
N15W24250 Riverwood Drive	Pewaukee	Wisconsin	142,952	51.7	AT&T	5.2	Sep 23
402 Franklin Road	Brentwood	Tennessee	347,515	116.0	AT&T	12.1	Nov 23
7337 Trade Street	San Diego	California	499,402	194.0	AT&T	16.3	Dec 24
Total			1,080,558	387.9		37.3	

Source: MINT

SECTOR CATALYSTS

- Continued growth from cloud service providers and social media companies.
- Land and power constraints reducing future supply of data centres.

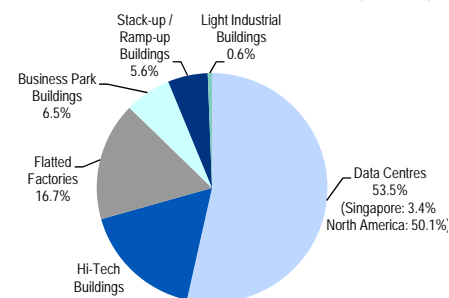
ASSUMPTION CHANGES

- We maintain our existing DPU forecast.

RISKS

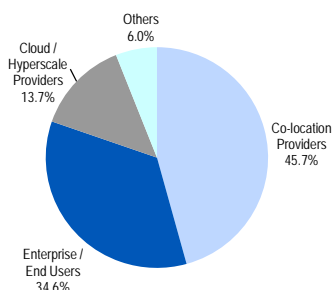
- Slow progress in securing replacement tenants for vacant data centre spaces.

PORTFOLIO VALUATION BY ASSET TYPE (DEC 22)



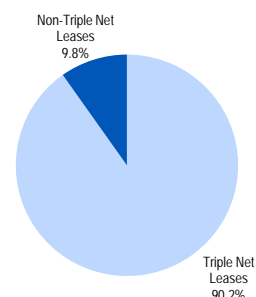
Source: MINT

TENANT TYPE BY GROSS RENTAL INCOME (MAR 22)



Source: MINT

LEASE TYPE BY GROSS RENTAL INCOME (MAR 22)



Source: MINT

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