Tech Support

Data centers are propping up the state's otherwise lackluster commercial real estate market. Yet credit constraints are putting a damper on future construction.

Builders Group recently finished the interior construction of a 163,500-square-foot complex in North Bergen for Switch and Data Facilities Co.

By Maria Wood

It's close proximity to the financial hub of Manhattan and good power supply makes New Jersey an attractive location for data centers. Nevertheless, the sector has been nicked by the economic downturn, throwing the ability to build new properties into doubt.

Data centers come in two broad categories—facilities developed by large financial corporations or investment banks to fulfill their massive IT and backup information needs and co-location centers built by third-party providers that serve as data depositories for multiple entities, ranging from financial services firms to healthcare and educational institutions and everything in between, including government agencies, Internet/telecommunication outfits and Web 2.0 companies.

The third-party providers are the most active of late, opening several sizable projects in the Garden State, thereby making this user group a rare bright spot in an otherwise hazy commercial real estate market.

In the spring, Telx, a provider of co-location data center services, opened a 24,000-square foot facility in Clifton. Around the same time, Russo Development LLC, one of the most active data center developers in the state, signed Cervalis LLC, another co-lo provider, to a long-term lease at a 148,191-square-foot building in Northern Jersey. (Because of security concerns, Russo declined to give the exact location.)

Another third-party provider, DuPont Fabros, is now building a 300,000-square-foot center in Piscataway. In 2008, Digital Realty Trust, a REIT focused on data center ownership and development, acquired a 127,800-square-foot building shell in Franklin Township. The REIT now has four facilities in New Jersey totaling one million square feet.

Colton Brown, managing director for FirstService Williams in Parsippany, worked on the Dupont Fabros deal, its first in the Garden State, back in 2007. "Dupont has a large presence in Virginia and California," he recalls. "It recognized New Jersey as one of the primary markets it wanted to be in. We were out for the better part of the year looking at sites that could accommodate a large campus-like facility."

Dupont eventually settled on a 38-acre parcel in Piscataway. "The site-selection criteria for Dupont is standard for any large requirement like this," Brown details. "You need a tremendous amount of power from multiple carriers in close proximity because it's very expensive to bring in power and fiber."

What makes the Garden State a first-rate location for data centers is its stock of available sites that can tie into a robust electric power source at a relatively low cost. What's driving demand for data centers, overall, is the increasing reliance on the collection, storage and analysis of electronic information.

Telx, a provider of co-location data center services, recently opened a 24,000-square-foot facility in Clifton.

"New Jersey has facilities that almost immediately meet the needs for a data center," says George Figliolia, president of New York City-based Builders Group, which recently finished the interior construction of a 163,500-square-foot complex in North Bergen for Switch and Data Facilities Co. "You can adapt an existing building faster than you can build. It's convenient from a connectivity point of view and it's close to the financial and information markets of New York City. That's created an influx of data centers in New Jersey."

"New Jersey has facilities that almost immediately meet the needs for a data center."

GEORGE FIGLIOLIA
Builders Group

The North Bergen building is owned by Hartz Mountain. Builders Group was brought in to outfit the inside for Switch and Data requirements, a project that cost $61 million, Figliolia relates.

In their search for a site, data center operators veer toward an existing building, most likely an industrial facility, finds William P. Steffens, area development manager for PSE&G in Newark. He aids companies, whether it be a financial services company or investment bank or a third-party provider, in picking a suitable site. "The likelihood is that they will have to gut it and possibly knock it down to make it conform with the data center reuse," he explains. "But it makes it a lot easier from a zoning, variance and land-use perspective. And it makes it quicker to market. They are usually looking at an 18-month lead time, so they are generally looking for existing buildings."

According to the New Jersey Economic Development Authority, New Jersey is home to six million square feet of data center space at the present time. Two years ago, the state had about a million to two million square feet, says Steffens.

Among the elements that are critical for a data center project are the power, water and telecommunications infrastructures in the area as well as environmental factors, such as whether the site is prone to flooding or other natural disasters, details Michael Pembroke, senior vice president of leasing of Russo Development, which owns 1.4 million square feet of data center space in the state.

Northern New Jersey is particularly suitable for financial companies' backup data centers due to its proximity to Manhattan. "The rule of thumb is a 50-mile radius from Midtown Manhattan is usually a good location for these types of facilities," Pembroke says.

However, development of new data centers or conversion of existing buildings to such usage presents a unique set of challenges. For one, time frames are usually short yet the work is complex. "Whenever you build something on an expedited schedule, quality is always a big concern," Figliolia says. "You need more supervision and testing to make sure the product is good. The good news is the quality of engineering, architecture and the subcontractors is usually very high because it is a highly technical, costly installation. Therefore, some of the problems are mitigated if not eliminated because the talent level is so skilled."

Yet like all other real estate segments, future development of data centers has been stymied by the current financing shortfall. Even major corporations find it difficult to get the funds required to build their own data centers.

Due to a number of special factors, such as a higher-than-normal power capacity and an ample amount of raised floor space that is sturdy enough to hold heavy equipment, building a data center from the ground up can mean a capital outlay ranging from $1,200 to more than $2,000 a square foot. By way of comparison, a standard office building pencils out to a fraction of that cost, running anywhere between $150 and $275 a square foot.

Faced with such a large expense, companies would rather take space in a co-lo facility, which houses data for many entities. Some of the larger financial institutions are finding they have maxed out capacity at their own data centers and therefore need to lease space in a co-location center. Yet even third-party providers are having a hard time getting funds, resulting in a fall-off in new construction.

"A lot of large firms that were building their own data centers aren't because they don't have the CapEx budget to do so," says Dan Golding, vice president of TierI Research, a Bethesda, MD firm that tracks the data-center sector worldwide. The same is true for data center-specific firms that now cannot obtain debt financing. "That's put a real dent in construction activity," he says. "Yet at the same time demand is high."

Pembroke concedes the current economic slump has made companies reluctant to pursue a costly data-center deal at this time. "We've seen a good amount of requirements out there put on hold indefinitely until the financial crisis is resolved," he says.

Sean Brady, senior director at Cushman & Wakefield in East Rutherford, reports there are 36 co-lo centers in the state now, a number that is likely to remain static. "Co-lo operators and corporations have stopped building any of their data centers just because of the poor economy and the credit crunch," he says.

Beyond the funding difficulties, finding more than one power source is proving to be a hurdle. "The ideal situation for a data-center operator is to have two sources of power coming from two different substations," Brady relates. "Most of the data centers that are out there are most often on a single power feed because the cost to have two sources is almost cost-prohibitive. You're talking in the millions of dollars to do that."

> "They are usually looking at an 18-month lead time, so they are generally looking for existing buildings."

WILLIAM P. STEFFENS
PSE&G

Consequently, the current trend is to lease data-center space rather than build, which has turned out to be a boon for companies like Telx. "People who are trying to figure out a way to lower their operating costs have decided to outsource their data center or their technology operations," says Tesh Durvasula, chief marketing and business officer for Telx, which operates a dozen data centers in North America. "We are seeing very strong demand."

Further, firms are looking for occupancy-ready properties, Pembroke adds. "Before, we would build a shell and core with utility infrastructure," he says. "Now, we are getting some requests to provide a full turnkey solution where we would build out the entire data center and lease it to them at one rate as a package."

Capital constraints notwithstanding, several large institutions are under way on their own data warehouses. Morgan Stanley recently broke ground on a 250,000-square-foot facility in Franklin and published reports have stated that Russo Development is developing a 400,000-square-foot data center in Mahwah for the New York Stock Exchange, although Russo declined to talk about that project.

Occupancy rates are hard to come by. (Tier1 declines to give out its proprietary information.) Those that scour the market for available space, however, report those six million square feet are nearly fully tenanted, particularly facilities that have been up and running for a number of years.

FSW's Brown estimates that there are roughly 150,000 square feet available in existing facilities and of that, 60,000 have the requisite raised-floor accommodations. Just opened facilities, like the Telx Clifton facility, offer the most available space, C&W's Brady finds.

Tier1's Golding says that the New York/New Jersey region ranks within the top five data-center markets worldwide. Occupancy, he says, is measured not by the amount of square footage tenanted, but how much of that space is actually utilized for IT equipment. "Right now that number is in excess of 85%, which for a data center is full," he says. "The level of demand for data-center capacity in New York/New Jersey is extremely high."

In a co-lo facility, a company typically signs for what is termed a cabinet, or a 30-square-foot area where the equipment is stored. In the New York/New Jersey region, a cabinet leases for between $800 and $2,000, Golding says. The third-party providers offer a menu of services that varies from simply making sure the electric power stays on to the actual maintenance of the application being used.

Another option is to go into an abandoned data center, of which there are several around the state. Although they garner a lot of interest, such older facilities may not meet today's power requirements. "It may have capacity of 50 watts a square foot," Steffens says. "A new one needs 100 to 200 watts a square foot. We work with the owner to determine whether we can provide the capacity they need and if we can't we let them know that upfront."

> "Co-lo operators and corporations have stopped building any of their data centers just because of the credit crunch."
>
> **SEAN BRADY**
> Cushman & Wakefield

Even though the development of new data-hosting facilities is currently on a hiatus, there is an enormous amount of pent-up demand not only from the users of data-center space but the co-lo providers that want to have facilities up and running when the economy turns. Regardless of the economic conditions, our society's seemingly endless capacity to generate electronic data ensures the need for more facilities to store that information. There is also the breakneck speed of technological changes that could make a data center obsolete in an eye blink.

"The longer they delay these projects, the further they get behind with the technology they have in data centers or the ability to provide new applications or new products," Steffens says. "We are seeing more people starting to look."

Likewise, Brady reveals that co-lo providers are now looking for new facilities, despite the lag in demand. "These data-center operators know there is a fair amount of pent-up demand that is developing within the marketplace," he says. "One would hope they could obtain funding for new centers toward the end of the second quarter of next year and that there will be a new supply coming on line the second half of 2010 and into 2011."

For its part, Russo plans to stay active in the market. "The financial crisis is reaching the data center sector," Pembroke admits. "But the trends point to increased activity in the coming months and years."—RENJ