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DATA CENTER INCENTIVES: STRENGTHENING TEXAS'S COMPETITIVE ADVANTAGE

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Executive Summary

- Rapidly expanding network traffic and the need for businesses to store, manage and distribute information are driving unprecedented demand for data centers.
- Texas's new data center tax incentive program enhances the state's relative cost advantage, adding to its existing attributes of abundant, relatively low cost power, robust fiber infrastructure, large and well-educated work force, low cost of living and affordable real estate.
- Data centers can have a meaningful effect on the Texas economy with total economic impact estimates ranging from nearly $500 million for a small facility to $1.7 billion for a large facility over 10 years.

TEXAS HOUSE BILL 1223

This legislation, signed by Governor Rick Perry in June 2013 to take effect September 1, 2013, creates a new data center tax incentive program. The program provides 100% exemption of sales taxes on business personal property essential to data center operations. This property includes items such as computers, electrical equipment, cooling systems, power infrastructure, and software. The sales tax exemption may be available for 10-to-15 years and can be accessed by owners and tenants in single- or multi-tenant data center properties. To qualify for the sales tax exemption, the data center operation must meet the following minimum thresholds:

- Consist of at least 100,000 square feet of gross building area in an entire or portion of a facility
- Involve at least $200 million of total capital investment
- Create at least 20 new direct jobs
- Pay wages equivalent to at least 120% of the county average

In basic terms, data center facilities house equipment, such as servers and routers, for the processing, storage and distribution of data. These operations meet the general business needs of maintaining critical IT infrastructure, cloud computing and disaster recovery requirements for firms across all industry sectors. Data center demand has reached unprecedented levels today and, with more consumer and business activity moving online, should continue to grow going forward.

To understand the scale of the information crossing residential, business and mobile networks, Cisco developed a Visual Networking Index to track and forecast global IP traffic. The 2012-2017 Forecast reported that global IP traffic has more than quadrupled over the past five years and is expected triple by 2017 as wireless/mobile devices are more widely used, video traffic increases, and speeds for broadband, mobile and Wi-Fi continue to rise. This

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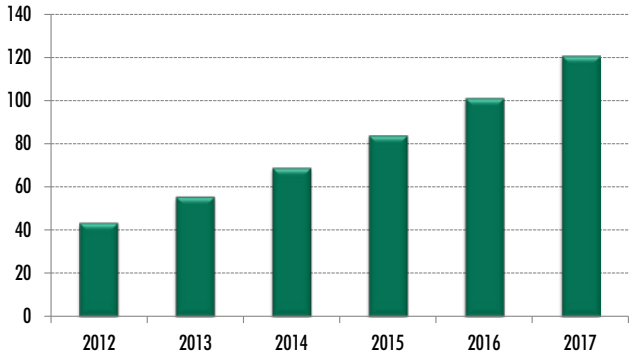
forecast is illustrated in Figure 1 using exabytes per month. One Exabyte is equivalent to one trillion megabytes. Using more familiar terms, Cisco explains that the nearly 44 exabytes crossing the global internet each month in 2012 is equivalent to 8 billion DVDs and the forecast for 2017 is equivalent to 30 billion DVDs. This growth in traffic is a significant tailwind for data center demand.

Figure 1: Global IP Traffic Exabytes Per Month



Source: Cisco, CBRE Research, May 2013.

SITE SELECTION DRIVERS

The site selection process for a data center generally involves finding the most reliable, dependable and cost effective location. Most companies choose communities based on four primary drivers[1]:

- **Power:** cost per kilowatt hour, carbon footprint, fuel mix and infrastructure
- **Telecom:** fiber providers, latency
- **Geography:** proximity to headquarters or airport locations, population size, labor and supplier quality, and water availability
- **Climate:** environmental risks, such as hurricanes, tornados and earthquakes

[1] Lenio, John and Patrick Lynch; Data Center Perspectives; CBRE Data Center Solutions Group and Economic Incentives Group, July 2013.

Click above to watch a discussion on the impacts of Texas House Bill 1223.

Texas compares favorably on these factors, indicating that many communities could be attractive data center locations. With its own electric grid, Texas has an ample supply of power at relatively low cost. The state has a robust fiber infrastructure and a central location that allows for sites with relatively low climate risk. Fifty-two companies on the 2013 Forbes 500 list are headquartered in Texas, which is also home to two of the busiest airports in the U.S.[2] There is also an ample population of 26 million people and a well-educated labor force.

Real estate availability and cost are the next factors affecting data center location decisions. Texas communities offer relatively affordable land, development and occupancy costs compared to alternative locations across the U.S. After real estate, taxes and incentives are the last remaining costs considered in a location decision. Given the capital intensive nature of a data center, these facilities face relatively high sales and property taxes. Thus, the larger the project investment, the greater role incentives tend to play in the location decision. Click here for more on the CBRE Data Center Solutions Group.

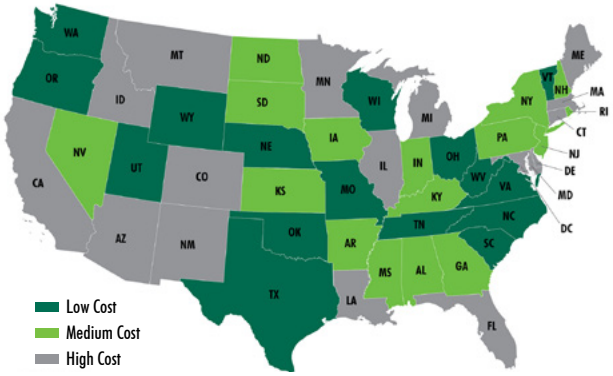
TAX POLICY AND INCENTIVES

Seventeen states have passed customized incentives for data centers since 2005, including the program in Texas. Similar to the Texas incentives, programs in other states generally provide full or partial exemptions from sales taxes on varied investment items when minimum thresholds are achieved.

[2] In the U.S., Dallas/Fort Worth International Airport ranks fourth and Houston's George Bush Intercontinental Airport ranks eleventh on Airports Council International's 2012 rankings, March 2013.

Prior to the incentive legislation in Texas, relatively higher sales taxes in the state generally led to a cost disadvantage for data center location decisions. The combined state and local sales tax in Texas can range from 6.25%-to-8.25%, depending on the local rate. This means that for every $10 million of investment in computer equipment, there would be between $625,000 and $825,000 in sales taxes. Both the state-level sales tax and the average combined state and local rates in Texas rank among the top quartile when compared across the nation[3]. With the new incentives legislations, Texas can be among the low cost states for data centers as shown in Figure 2.

Figure 2: Data Center Tax Rankings



Source: CBRE Economic Incentives Group, August 2013.

Also supporting Texas's low cost ranking is its favorable business tax structure. Texas does not have a corporate income tax and, although the state does levy a franchise tax, it is primarily based on gross receipts or sales occurring in the state. Even if incurred, marginal franchise taxes in Texas could be the lowest when compared to the most competitive states for data center locations.

Thus, the new data center incentive program strengthens Texas's competitive advantage in data center location decisions.

[3] Drenkard, Scott; Fiscal Fact: State and Local Sales Tax Rates in 2013; Tax Foundation, February 11, 2013

ECONOMIC IMPACT

If a Texas community was selected for a data center development, the most significant direct economic impact is generated by capital investment. For newly constructed facilities, data centers can create a significant amount of construction employment for the period of construction, which is typically two years. Upon completion, however, data centers tend to have minimal job creation, although these positions command relatively higher salaries.

The CBRE Economic Incentives Group has studied the potential economic impact of a new data center development on a typical Texas community. For an average small data center of 150,000 gross square feet and about $390 million of total capital investment, the total economic impact is estimated at nearly $500 million over 10 years. An average large data center of 460,000 gross square feet and $1.3 billion of total capital investment would have a total economic impact of about $1.7 billion over the same period. The table below provides their detailed conclusions:

Figure 3: Texas Economic Impact Summary

	Direct Impact	Total Impact[1]
Small Data Center		
Construction Jobs	794	1,430
Direct Jobs	16	46
Total Payroll	$53,800,000	$95,592,000
Potential Retail Sales	$74,427,200	$89,364,000
Economic Activity	$374,164,000	$499,032,000
Large Data Center		
Construction Jobs	2,941	5,366
Direct Jobs	64	184
Total Payroll	$203,100,000	$361,476,000
Potential Retail Sales	$276,808,800	$333,356,000
Economic Activity	$1,244,656,000	$1,716,928,000

[1] Includes direct impacts as well as indirect and induced. Indirect includes suppliers supporting the operation. Induced includes jobs created from the spending of wages of the direct and indirect employees on goods and services.

Source: CBRE Economic Incentives Group, CBRE Consulting, June 2012.

These facilities, once built, are a key component to a company's overall operating environment and can create a long term investment in a community. Similar to other industry clusters, data centers also tend to group together, compounding the potential economic growth in a community.

FOR INFORMATION ABOUT THIS CBRE TEXAS VIEWPOINT:

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