

Data centers: The alternative investment asset class

The data centers industry is growing and catching the attention of global investors

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It is an exciting time to be a part of the global data center industry—the world's ever-increasing demand for more data will continue to drive growth exponentially, explains **James Dodsworth**, partner and leader of the data centers group at global law firm White & Case.

Data centers are at the heart of our modern world. Their infrastructure supports myriad digital functionality. As technology develops at pace, so too does our dependence on the storage and manipulation of data by secure, reliable and efficient means.

Often referenced as the "factories of tomorrow", they are the modern face of commercial real estate whose dramatic growth has, in large part, been driven by the technology companies that are themselves "disrupting" their own industries and markets.

As the sector continues to mature, broaden and grow in profile, so it has attracted an increasingly broad following of investors, many of whom see the promise of heightened returns when compared against more traditional real estate and infrastructure asset classes.

Historically seen as complex from an investor and lender perspective, the sector has to a large degree been dominated by the large owners/developers/operators in the market who, hungry for growth, have expanded into new international markets as demand from their key global customers drives growth. Consistent organic customer growth has been supplemented by

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Very few asset classes have the global reach, growth trajectory and investor appeal that data centers enjoy today

increasingly large-scale cross-border M&A activity.

In 2017 alone, global M&A transaction values in the sector were, according to CBRE, in excess of US\$25 billion.

Data centers have established themselves as a core member of the "alternatives" real estate sector alongside logistics, self-storage, student housing, healthcare and hotels and leisure.

Equinix's acquisition of UK-listed operator TeleCity Group PLC (transaction valued at approximately US\$3.8 billion) reportedly doubled Equinix's European offering, with 40+ data centers being added to its European portfolio. The nature of the transaction was such that it caught the attention of the European Commission.



The European Commission directed as a condition to the transaction proceeding that Equinix comply with specific "commitments" including a requirement to sell (or divest) itself of Telecity data centers in each of London, Amsterdam and Frankfurt.

For the first time in Europe, European governing bodies were directing and shaping the future landscape of the data center industry. It was an important precedent in the evolution of the asset class and in practice meant that every new large-scale transaction in Europe could expect to be subjected to closer scrutiny.

But far from limiting the appetite of investors, these developments have arguably only served to heighten interest. Real estate private equity and sovereign wealth funds from around the world have started to invest in and exit on their investments in the past few years as the asset class starts to mature. In turn, the number of senior lenders looking to offer financing not just on the plant and equipment but on the entire asset has increased and, with the greater availability of asset-level finance, so more investors have been attracted.

As Andrew Jay, Head of Data Centers at CBRE, comments, "There is really no 'one type' of investor looking to access the sector—the growth of the industry is attracting an array of investor companies."

But inevitably there are challenges to overcome. In Europe these derive not only from issues such as Brexit, but also an increased focus on protectionism and data sovereignty. As courts, regulators and governments seek to exercise legal control over data, the concept of sovereignty has pushed up hard against the globe-spanning data flows on which modern commerce relies. It has proven difficult to apply traditional legal principles to data that only fleetingly reside in any one location.

To ensure that law enforcement agencies are able to gain access to such data, governments around the world have implemented data localisation laws, either in certain sectors (e.g., financial services, telecoms, etc.) or across the board, to ensure that a copy of the relevant data is held locally. These developments clearly present challenges to the data center industry—but they also create significant opportunities for data center providers that are able to supply the services that enable their multinational clients increasingly to satisfy the requirements of these laws.

Industry commentators certainly continue to expect the sector to grow. "In the European markets, 2018 is likely to surpass 2017 in transaction volume," says Martin Carroll, co-head



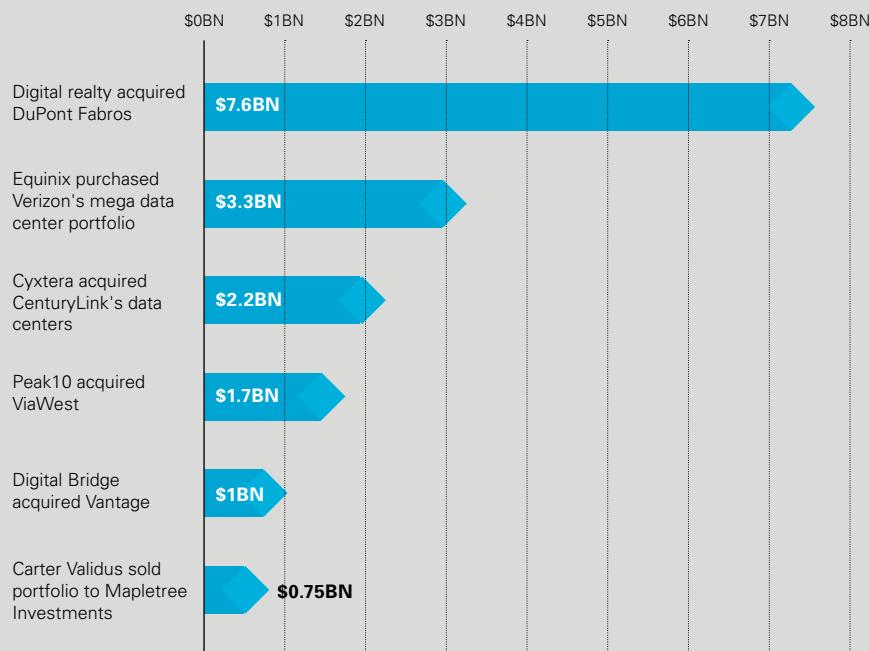
Average cost of a service outage

Source: FT.com

of the data center group at JLL. "With a number of deals already underway across the continent, we see the largest interest from global businesses using acquisitions to establish a new European footprint. Local players are also active where activity is accretive to their existing portfolios. We expect the next three years will see the top-ten league table in Europe change dramatically."

There are very few asset classes today that have the global reach, growth trajectory and consequent investor appeal that data centers currently enjoy. In this increasingly connected world, the ability to manipulate large-scale data is critical to business efficacy, development and success. Given such a background, it is a fabulously exciting time to be immersed in all aspects of this very modern global industry.

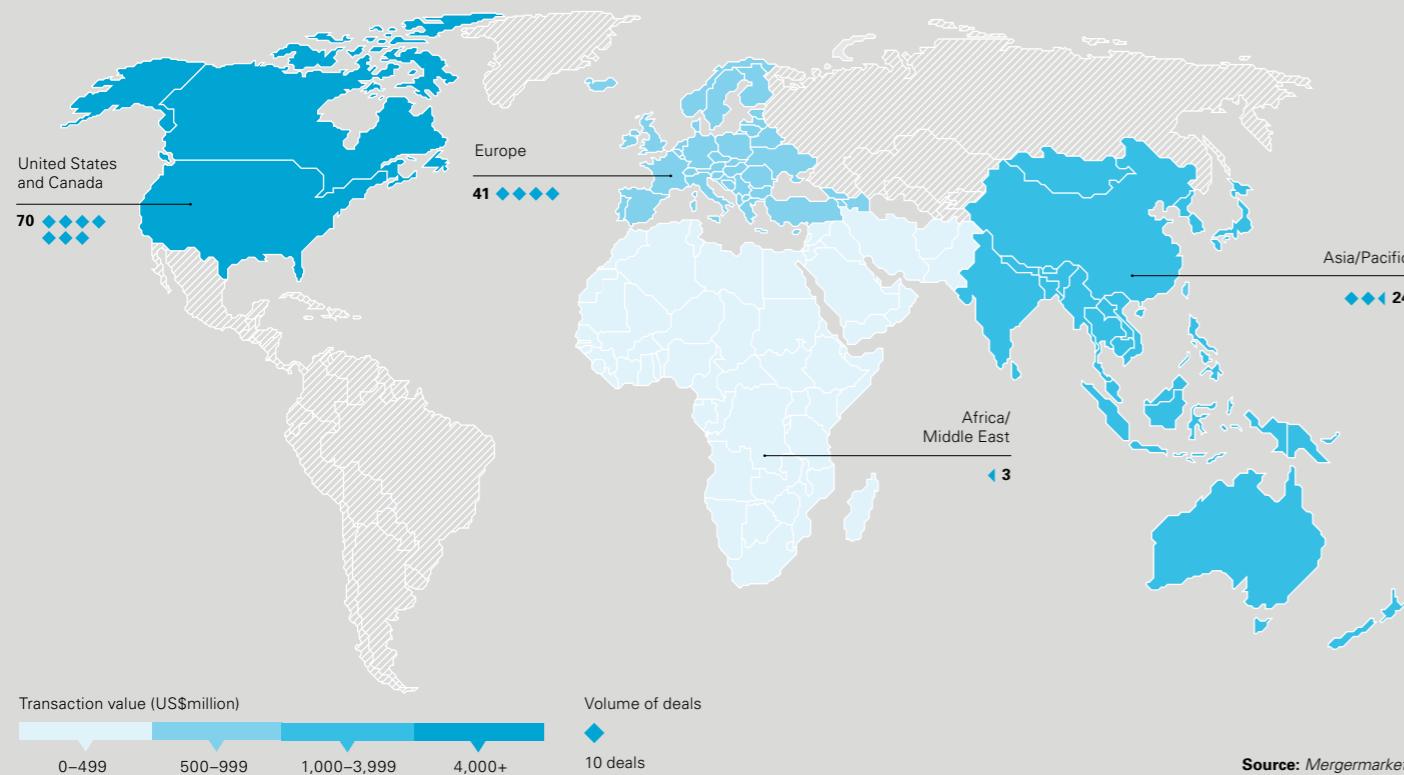
Top 2017 M&A



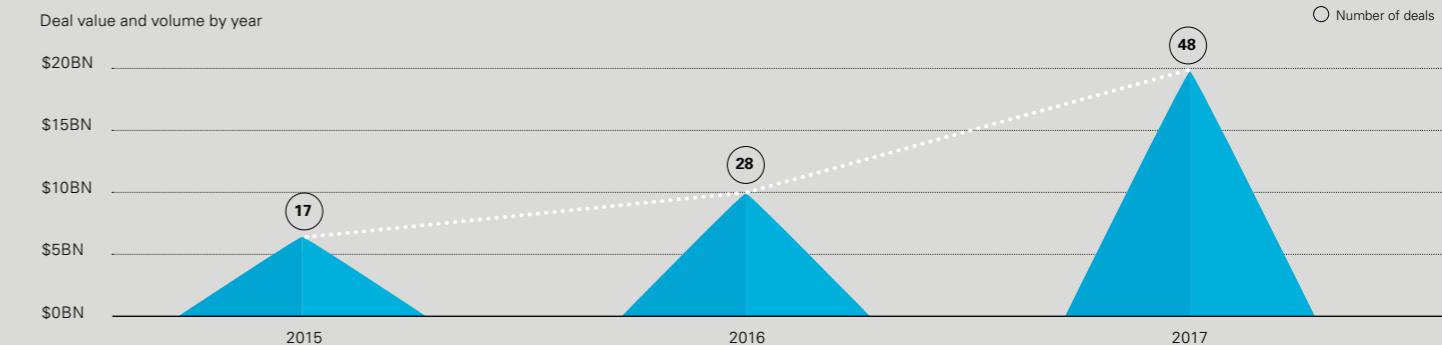
Source: JLL

Data center M&A activity

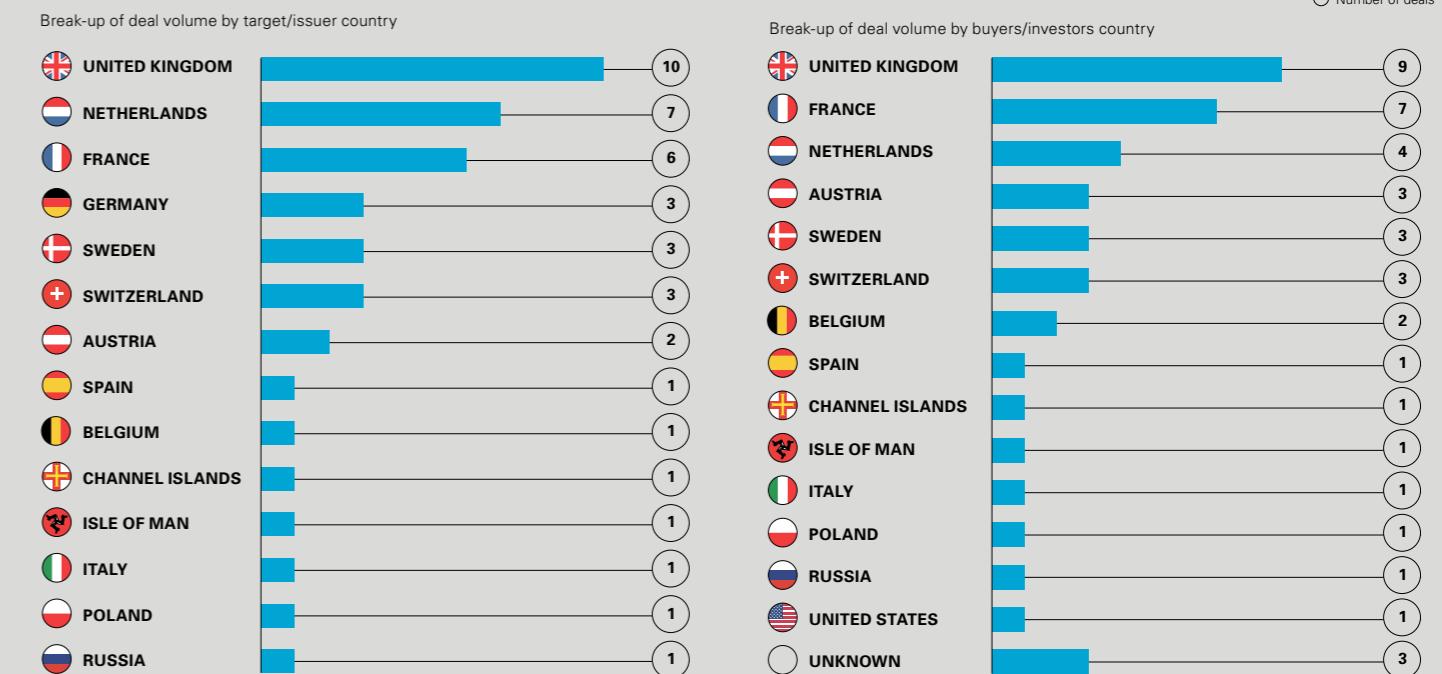
M&A deals in global data centers market (2014–2017)



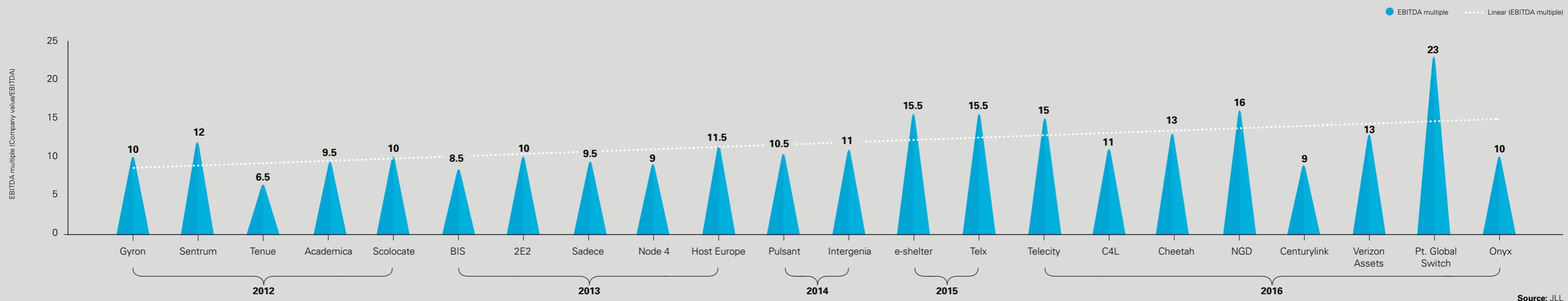
Data center M&A activity



M&A deals in European data centers market (2014 – 2017)



Data center M&A transactions 2012 – 2016



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