

SPECIAL BULLETIN #7 | DATA CENTRES A FOCUS ON THE TENANTS



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As data centres become an increasingly attractive investment opportunity, it's important for investors to understand the types of organisations that are driving demand for these facilities.

Broadly speaking, there are three categories of data centre tenants: enterprise users, colocation service providers, and hyperscale cloud service providers. The third group, hyperscalers, has received much of the attention from investors due to the growth prospects of these companies (i.e., Google, Amazon, Microsoft) as more data shifts to the cloud.

However, we believe there are significant investment opportunities across the whole spectrum of data centre tenants. Following is an overview of each of these three groups, as well as our perspective on why each presents attractive investment characteristics.

Enterprises: Transitioning to a hybrid approach

Enterprise users, mostly large corporations with a significant global footprint, typically have massive data storage and processing requirements. They have historically maintained their own off-site data centre facilities, especially in the wake of the 9/11 crisis, where a significant amount of corporate data was lost.

Today, these companies are moving parts of their data requirements to public cloud providers. However, they don't seem willing to move all of their data to the cloud due to security requirements or data privacy regulations, such as the European Union's General Data Protection Regulation (GDPR). These policies have significant penalties associated with them, making companies extremely cautious when it comes to data management. The rise in digital espionage and the media coverage of these events has also led to a reluctance from corporations to put personal data in a public cloud.

At a glance—Data centre tenant groups

- **Enterprises:** use in-house data centres due to privacy regulations, security requirements, or other proprietary needs.
- **Colocation service providers:** offer infrastructure on a more scalable level, allowing users to access high-quality data centres without the large upfront costs.
- **Hyperscalers:** are the fastest growing data centre segment and use a shared infrastructure to allow customers to outsource data storage.

In addition to data security, companies choose to maintain their own data centres in order to host proprietary applications and use the facility as a central network connection point. Corporations are also driven to expand the number of facilities in diverse geographic locations. This helps create redundancy while also providing closer proximity to the end users of the data.

While the need for in-house data centres remains, many enterprises are adopting a hybrid approach by outsourcing some functions to a cloud service provider. In the last two decades, many of these companies have been forced to re-think how they store and manage data. A number have employed new strategies to allow for continued digital platform growth without spending huge amounts of capital.

As a result, the best solution for many companies has been outsourcing their data infrastructure needs to leased space, which has proven to be less expensive and more efficient. Much of this outsourcing has been driven by the increasing complexity and sophistication needed to run a data centre. As companies shift away from owning these assets, they're moving more data to public and private cloud storage solutions, as well as to colocation facilities.

Colocation providers: Sharing resources

Colocation service providers, particularly popular among small- to medium-sized businesses, provide storage and processing infrastructure on a scalable level. These types of facilities allow users to access high-quality data storage and processing without the large upfront costs, somewhat akin to how a logistics company such as DHL or FedEx manages logistics for those companies without the resources or desire to do this in-house.

There are two types of colocation operators: wholesale and retail. The most evident distinction between them is how they charge for power—wholesale operators pass the cost of power on to the end user without any sort of markup, while retail operators sell the power for a profit. Other differentiators:

- Wholesale operators spend a large portion of their time catering to cloud service providers, whereas retail providers tend to offer more specialised data centres, such as private cloud solutions.
- Corporations tend to work with retail operators because these specialised services offer more bespoke services than wholesale operators.

Much of the retail space is comprised of smaller data centres, with a number in the heart of population centres known as “edge data centres.” These edge facilities have proven to be very useful at enabling the deployment of latency-dependent 5G mobile technologies, given that they allow for very quick data processing. For now, these facilities are used for services like Netflix streaming, online gaming, and videocalls, but going forward they will help facilitate AI and machine learning technologies.

Colocation providers have been growing and maturing in recent years, presenting new opportunities for data centre investments. This growth is being fueled by large users seeking additional locations, as well as the increasing online presence and reliance on data connectivity from small and medium businesses. These providers have improved their credit worthiness as they have taken on new assets, diversifying income streams and becoming less dependent on any one particular site.

The strengthening financial covenants of colocation providers is a major catalyst for the improving outlook for these assets as real estate investments.

Hyperscalers: High growth in the information economy

Hyperscaler cloud service providers are the fastest growing segment of data centres. These large tenants—the biggest include Google, Amazon, and Microsoft—use a shared infrastructure to provide customers networking, infrastructure, and applications as a service. This model provides economies of scale for the tenant, allowing them to focus on core businesses and provide their geographically dispersed customers ease of access to data storage and processing.

Hyperscalers generate economies of scale by combining similar functions for multiple customers in a single facility. The ability to deploy standardised equipment across facilities results in the highest power density of data centre types. In general, these cloud service providers offer massive amounts of flexibility to their customers, allowing them to subscribe and pay only for data used.

In Europe, hyperscaler tenants have historically taken space in wholesale colocation facilities. Today, they’re increasingly focused on self-building their own data centres in the most developed European regions, including Frankfurt, London, Amsterdam, and Paris (the FLAP markets). However, the ability for them to self-build is limited by the availability of sites with adequate power. Because of existing high barriers to entry and a need for aggressive growth, these companies are struggling to develop their own facilities and continue to occupy significant space in wholesale colocation sites.

Growth opportunities across the spectrum of tenants

While there’s justifiably a great deal of investment capital chasing the rapidly growing cloud services segment, we believe the opportunities to invest in data centres goes beyond this segment of the market. One example is the retail data centre space, a segment that has experienced very steady growth.

According to data provided by CBRE, retail colocation facilities in the FLAP markets have grown on average by roughly 10% each year since 2015. Comparing this impressive growth to other real estate segments—or, really, any other asset class—makes it abundantly clear the colocation market remains an incredibly attractive space.

In addition, we're finding that corporations and other end users are becoming much more sophisticated with how they manage their data. Many are increasingly looking for not just a cloud service provider, but rather a diverse mix of data management solutions. This may include using the public cloud, such as Amazon Web Services, along with a private cloud managed-services data centre. These end users are focused on integrated solutions that span multiple types of data storage and processing.

While this trend was in place before COVID-19, the pandemic has led many data centre users to accelerate

plans to reimagine and realign their IT infrastructure to ensure it's set up for future success. They need data management that is both efficient and scalable.

The demand for a diverse approach to data management is creating opportunities for services that help data centre tenants streamline their approaches. It's also creating new investment opportunities. Combined, we believe these opportunities will continue to expand across the major tenant types and we remain optimistic on the outlook for data centre investments.

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