

SPECIAL BULLETIN #3 | DATA CENTRES

EUROPEAN MARKETS EMERGE AS A HOT SPOT



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Major markets in Europe are experiencing dramatic growth in data consumption—driven by innovative economies and high personal incomes. As a result, critical data centre hubs have emerged in the commerce centres of Frankfurt, London, Amsterdam, and Paris (often referred to as the FLAP markets), forming the core of a system crucial to both European and global economies.

While the demand for data is beginning to push users outside these regions, the FLAP markets currently represent an overwhelming majority of data centre locations. As enterprises, colocation groups, cloud service providers, and other tenants drive demand for these facilities, a lack of supply creates an opportunity unique to Europe.

Core markets connect the globe

The use of data for nearly any purpose requires two critical components—connectivity and power. Linking data networks across geographic borders creates a reliance on the fibre cables that connect the globe. For data centres in Europe, the most important of these international cables links New York to London, then to a number of major European cities before connecting to Asia and Africa. The further a data centre is from these international fibre connections, the more latency (i.e., delays in data transmission) there will be, which is why the FLAP markets have become attractive for data centres.

Each of these core markets are population centres with substantial business activity and an intensive requirement for data storage and processing. With data processing speed a top priority for both businesses and consumers, the locations of these hubs help provide low latency for users. Core markets share similar characteristics, though each has their own strengths and weaknesses from an investment perspective:

- Frankfurt has strong environmental protections and is space constrained. In the third quarter of 2020, its vacancy rate was low, which likely will not change any time soon.¹ The city benefits from a strong financial services presence and serves as a gateway to the East.

At a glance – Data centres in Europe:

- **Connected:** Europe's core data centre markets are important gateways for global commerce
- **Growing footprint:** As demand for data grows, regional hubs are becoming more important
- **Supply/demand imbalance:** Barriers to entry boost the intrinsic value of incumbent data centres
- **Improving “investability”:** Institutional demand makes data centres more attractive investments

- London is the largest data centre market in Europe and home to many corporate headquarters. West of the city, hyperscale cloud service providers have set up zones that serve as hubs for data centres to provide their services. More recently, the north and east of London have attracted data centre interest, including that of Google. London has roughly 711 megawatts of commissioned capacity, representing approximately 41% of the total capacity in the FLAP markets.
- Amsterdam struggles with a lack of power, limiting supply of new data centres. Recently, a moratorium against development of new facilities has been lifted; however, its effect was to dissuade data centre companies from setting up new facilities there due to worries around ability to expand. Now that it is lifted, interest in the market can start to grow again. The government remains positive on the data centre industry's growth, citing some 30 anticipated projects scheduled in the next few years.²
- Paris is the smallest of the FLAP markets and has high power costs but remains significant in Europe. In 2019, the government created a new tax incentive for the development of data centres that would cut in half the price of electricity for certain projects, assuming they abide by specified environmental standards.³ The market has seen growing interest from both cloud service providers and enterprise customers. Vacancy rates remain low.

While not as big as the other four markets, Dublin is considered an emerging core region. The city has benefitted from its geography (between the big markets of the United States and the UK) and from a corporate tax regime that has attracted sizeable corporations, particularly in the U.S. Hyperscalers,

^{1,2} European Data Centres, Q3 2020, CBRE Report

³ Data Center Global Market Comparison, Cushman & Wakefield's Data Center Advisory Group

the largest cloud service providers, maintain a big presence in Dublin, home to Facebook and several other data-intensive companies.

Competitive barriers create opportunity

As these markets dominate Europe's data centre landscape, new entrants are faced with a number of challenges. The complexities of the space require high-level expertise. Finding ideal locations can be difficult, as data centres must be close to both an accessible power supply and a large population centre. They also require significant ongoing infrastructure investment (i.e., data protection, technology upgrades, chillers, and backup generators).

But the biggest hurdle to building a data centre in Europe is gaining access to a suitable power supply, largely due to regulatory limitations on energy consumption. While this may seem like an industry headwind, the reality is that restrictions and other roadblocks to entry have created an imbalance between supply and demand, essentially placing a higher value on existing data centres and making them more attractive investments. In any of Europe's core markets, a data centre with the right power contracts in place, plus access to international fibre lines, has a distinct advantage over new entrants. This supply/demand imbalance is not nearly as ubiquitous in the U.S. or other big data centre markets as it is throughout Europe.

Because FLAP markets have proven difficult to penetrate, many second-tier players in Europe are gaining attention as users seek other options for low-latency, high-bandwidth networks. Places like Zurich and Milan that have large populations, access to relatively affordable power, and good fibre connectivity are quickly evolving and becoming more attractive. As South America becomes increasingly linked with Europe, Madrid and Barcelona have become prominent locations. Marseille is a growing hub, with its dense population of fibre lines, and much of the connectivity to Africa is routed through the city.

Additionally, many companies choose to have their data centres located in their home countries for regulatory or data security reasons. This has sparked new centres outside Frankfurt in Germany, a country with strict data privacy laws.

Institutionalisation will improve the investment landscape

More than \$100 billion flowed into data centres over the last 10 years as institutional investors recognised the secular opportunity this sector presents.⁴ As data centres become more "institutionalised," there has been more contract standardisation and an increase in leases that pass operational costs from landlord to tenant (i.e., triple net leases). These investments are now more accessible and better understood than in the past.

With more European data centre assets in the hands of institutions—and the industry consolidates with M&A activity—these properties will only become more valuable. We are committed to expanding assets in core markets where there is opportunity to benefit from the demand/supply imbalance, but are also making targeted investments in second-tier European markets with growth potential.

As the world becomes increasingly interconnected, the data centre landscape will continue to evolve as fast as the technology within these facilities. The secular trends developing in European markets are presenting new and exciting opportunities for data centre investors, and we believe investments in this industry will continue to add long-term value to diversified real estate portfolios.

⁴ Data Center Global Market Comparison, Cushman & Wakefield's Data Center Advisory Group

Risk Considerations

Investment involves risk including possible loss of principal. Past performance is no guarantee of future results. Potential investors should be aware of the risks inherent to owning and investing in real estate, including value fluctuations, capital market pricing volatility, liquidity risks, leverage, credit risk, occupancy risk and legal risk.

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