CAPITAL MARKETS
ESG

Data centre securitisation in Europe

Simon Porter, Jeremy Levy, Sarah Porter and Joana Fragata of Baker McKenzie look at how trade receivables financing could be a valuable weapon in a data centre's financial armoury

The pace of digital transformation has been accelerating worldwide. As part of this continued growth trajectory, the use by corporates of data centres has become essential. The Covid-19 pandemic has given an additional boost to the expansion of the digital economy, as businesses adapt to home-working and additional data needs. Planning for an increasingly digital and innovative future will rely not only on the existence of appropriate infrastructure but also on the ability of market participants to access it.

In addition, the European Green Deal and the European Digital Strategy – an ambitious green and digital revolution led by the European Commission which impacts a number of different sectors of the economy – includes a target to decarbonise data centres by 2030. This will require substantial investment from European data centre providers and will undoubtedly prompt them to consider carefully the funding options available to drive this growth.

While traditionally data centres have been viewed as infrastructure assets, attracting infrastructure-specific financing solutions, they are rapidly becoming much more than that. The trend towards the provision of data centre services – through cloud-based solutions designed to serve end customers – is likely to require a reassessment of the existing approaches to their financing. This article considers how trade receivables financing could become a valuable financing tool for data centre providers in Europe.

The use of asset-backed financing in relation to data centres is a relatively recent phenomenon in the US – the first rated data centre securitisation closed in 2018. To date, these data centre securitisation transactions have typically involved securitisation of loans backed by data centre infrastructure through the issuance of commercial mortgage-backed securities (CMBS), whereby the rents paid by data centre tenants generate the required cash-flows to service

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the asset-backed securities. More recently, there has been a move to master trust platforms to securitise operational revenue.

In Europe, as at the date of this article, there have been no public data centre asset-backed financing transactions. This might be explained by the prevalence of loan and corporate bond financing in this sector and the reluctance of market participants to engage in novel transactions, where the lack of comparable experience may pose challenges to their pricing, structuring, rating and marketing to investors. Additionally, while CMBS has recently made a comeback in Europe, it has continued to focus on the traditional sectors (retail, logistics and hospitality), while infrastructure and whole business securitisation have not become widespread funding tools.

As the data centre sector evolves, alternative structures – other than the infrastructure or operational-based financing structures tried and tested in the US – may start to emerge as credible alternatives for financing of data centres, in particular as the sector evolves and the demands on data centre entities to expand and modernise their business intensify.

Colocation data centres have recently emerged as a flexible alternative for companies seeking to access data centre infrastructure without the associated heft and cost. The emergence of Data Centre as a Service (DCaaS) business models could have a profound impact on data centre financing, as the supply of DCaaS services will generate a stream of cash-flows arising from trade relationships which can be monetised using trade receivables financing, in particular asset-backed commercial paper (ABCP).

Compared to CMBS and whole business or infrastructure financing, trade receivables financing offers increased flexibility, allowing market participants to structure their own transactions or to tap into existing ABCP financing platforms, often at a pan-European level. ABCP is therefore a particularly effective financing tool for data centre entities operating across borders.

Trade receivables as an asset class

Moreover, trade receivables is an asset class with an established market in Europe. Over the past couple of decades it has endured testing market and economic conditions and proved its resilience. It is also seen by key stakeholders, such as governments, supranational entities and regulators, as one of the key tools to kick-start the post-pandemic recovery. The trade receivables market is particularly well suited to bespoke transactions and could complement other more traditional forms of data centre financing. Moreover, if carefully structured, trade receivables financing can be classified as a non-recourse sale of receivables which often falls outside of restrictive covenants in other finance documentation.

This is in contrast to traditional data centre securitisation, which has experienced significant cash-flow volatility, typically arising from the variation in business models and the heterogeneous nature of performance and quality indicators, cash-demanding character of the business (due to extensive capex and maintenance needs), risk of technological obsolescence and also fluctuating demand in line with customer preferences and technological advancements.

The financing of trade receivables generated by the provision of data centre related services may provide a degree of insulation from some of the typical risks and cash-flow volatility associated with data centre assets. Indeed, trade receivables financing shifts some of the investor focus away from the financed entity and places it on its clients: this may prove particularly useful for new market entrants who seek to access competitive financing while not having a significant borrowing track record. It is also a viable alternative to private equity funding, which invariably results in some loss of control over the business.

In terms of broadening access by data centre providers to different investor constituencies, few asset classes offer greater diversification, as a wide range of entities invest in trade receivables financing in the European markets, including both traditional and alternative lenders and other institutional investors.

ABCP transactions or other trade receivables securitisations may be eligible to qualify for recognition as "simple, transparent and standardised" securitisations, increasing their attractiveness for institutional investors due to the advantageous capital treatment afforded to such exposures under EU regulation. It should also be noted that the EU capital requirements framework recognises credit risk mitigation techniques such as the use of credit insurance in relation to trade receivables (provided certain conditions are met) and therefore provides further incentives for credit institutions and insurance companies to invest in trade receivables securitisation instruments.

Moreover, the credit enhancement effect generated by the use of credit insurance in relation to trade receivables finance may also supply data centre providers with a powerful tool to improve the credit profile of the trade receivables and attract funding at more competitive terms.

Trade receivables financing is not be the only way forward for financing the European data centre business. However, we are of the view it is a worthy weapon in a data centre's financial armoury. Data centre providers would benefit from looking at their trade receivables book in a new light and embracing the opportunity to unlock the value that their business already holds.

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