Navigating Europe's Data Centre Market

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The demand for data and the growth of the data centre market in Europe has been remarkable. Since 2019, the European colocation market has grown at a 24% CAGR, from 1,806MW to 5,833MW by H1 2024.[i] Despite the significant supply growth in that time frame, demand has grown at a faster rate. Absorption has materially outpaced new supply, in turn driving vacancy rates in Europe's FLAP-D (Frankfurt, London, Amsterdam, Paris and London) markets down from 10.5%, to 2.3%, the lowest level recorded.[ii]

This significant expansion in demand shows no indication of softening, with Q2 2024 absorption continuing to set new records, with 355MW of absorption across FLAP-D markets, 13% higher than the previous record quarter and almost 2.3x the average quarterly absorption level in these markets.[iii] As a result, absorption throughout the past four quarters has been greater than the previous eight quarters that preceded it.[iv] This does not however appear to be the peak of the market. Harrison Street believes we are in the early stages of a remarkable growth period for the sector. Demand in the medium-term (next 3-5 years) is set to strengthen as occupiers look for additional capacity to satisfy larger cloud adoption fuelled by artificial intelligence and machine learning requirements driving future demand.

While the sector provides an enormous opportunity for real estate investment in Europe, navigating some of the sectors' intricacies requires deep sector knowledge and experience. Harrison Street has an existing $4 billion digital platform in the US with established presence in the sector. We believe that the biggest hinderance to the growth of the sector are severe supply-side restrictions that plague Europe's largest data centre markets. While the availability of suitable land sites and planning restraints are an obstacle to the growth, as we see in other markets globally, power is the critical limitation to European data centre expansion. The scale of underlying demand from end-users has shifted dramatically in the past few years and the combination of much larger facilities, clustered in much larger markets, has put pressure on power delivery. In Dublin, there is a de facto moratorium on the building of new data centres and there are similar restrictions in place in central Amsterdam. While London, Frankfurt and Paris are better positioned, the timeline of projects to be delivered in these markets are projected to be longer than before, slowing the growth of the sector when demand remains brisk.

Navigating access to power now requires a different strategic approach. Historically, investors and occupiers could start a development with a non-binding agreement from utility providers. However, as power difficulties become much more widespread, developers and investors now require a formal agreement from utility providers before moving forward. This documentation outlines the timing and magnitude of power delivery, with agreements on the delivery of power at specific development milestones for engineering and infrastructure. This is not something unique to Europe but as power constraints in Europe are perhaps more restrictive most other data centre markets around the world, it is becoming imperative to commence a data centre project.

Power constraints are expected to lead to the growth of secondary markets

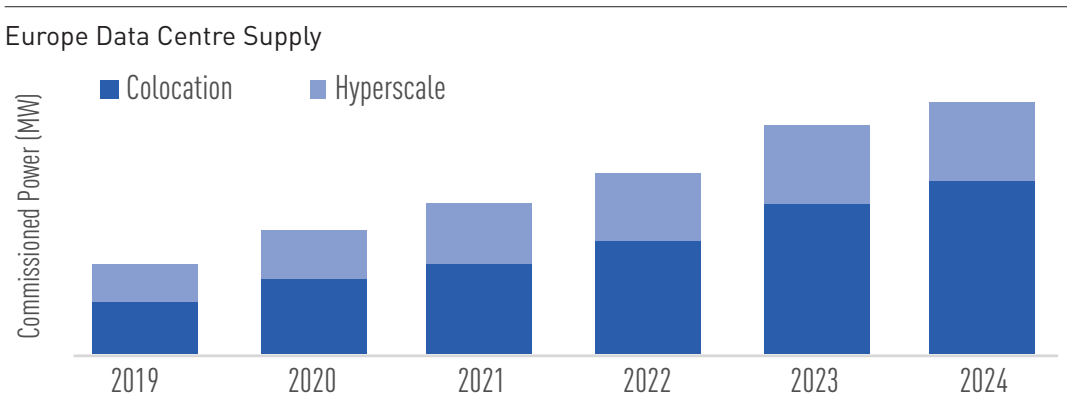
It is increasingly clear that the FLAP-D markets will not be able to support all of the continent's data centre capacity. While operators are exploring alternative solutions for power generation in core markets, the areas that represent the path of growth out of those primary markets are likely to become increasingly attractive to end-users. In these ancillary locations participants avoid some of the constraints of core markets, sourcing scalable land sites and power in a timely manner. We have already witnessed this in the US, as markets like Central Ohio have emerged as important destinations for large end-users supporting multiple hyperscale clusters. The region has benefitted from all of the traditional site selection criteria: strong connectivity, proximity to end users, low natural disaster risk and importantly abundant access to power. Areas with all of these ingredients as well as a supportive economic environment will continue to see significant growth.

Similar dynamics are playing out in Europe. Several secondary markets are poised to become core, hyperscale cluster markets. Markets such as Madrid, Barcelona, Milan and Berlin appear to be best placed to accommodate the growth in demand, simultaneously a number of newer, more nascent emerging markets possess the characteristics to evolve into data centre clusters. The growth of these other markets may be augmented by European regulation as governments exercise greater control over data sovereignty, which will create new clusters in domestic markets.

Other emerging trends

The continued growth of the sector will attract a greater array of market participants, particularly third-party developers. As demand increases, we believe that hyperscalers will not be able to rely solely on 'self-performing'. This is something that we have seen in the US and is starting to take place in Europe. In 2021, 42% of Europe's commissioned power had been developed by hyperscalers.[v] The share of Europe's commissioned power attributable to this group has fallen to 32%, as the size of the colocation market has almost doubled in the past two and a half years.[vi] Many third-party developers, previously with significant expertise elsewhere in the world, have established European platforms in recent years. These factors could act as a catalyst for the growth of other trends that are not yet widespread in Europe but are common elsewhere. In the US, powered shell data centres have become increasingly popular in the market and that is something that we anticipate will also evolve to Europe. Powered shells are large format industrial shell facilities with substantial power infrastructure. We believe that powered shells will becoming increasingly popular in Europe as they are ideal for occupiers seeking larger commitments, more control over build out and are often a speedier route to market.

The European data centres market provides a significant opportunity for real estate investment. The sector continues to outperform many traditional asset classes and the future growth of the sector looks set to be underpinned by the continued growth of strong credit, hyperscale occupiers. However, supply-side constraints will be one of the biggest obstacles to growth in the years ahead, as dramatic demand increases have put pressure on the power delivery. Navigating these obstacles requires significant know-how and operational expertise. Harrison Street seeks to leverage its track record in the digital sector to capitalise on the opportunities it provides, both now and for the future



Source: Data Center Hawk

[i]Data Center Hawk
[ii]Data Center Hawk.
[iii]Data Center Hawk. FLAP-D markets.
[iv]Data Center Hawk. FLAP-D markets.
[v]Data Center Hawk
[vi]Data Center Hawk