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European Data Centre Securitization

NOVEMBER 2025

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GlobalCapital's European Data Centre Securitization Breakfast Briefing

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Why securitization can be the key to data centre financing in Europe

Vantage brought the first public data centre ABS to market in Europe in May 2024. Since then, momentum has built around what could become a fast-growing segment of the securitization market. Banks are looking to recycle capital from their data centre loan books and investors are eyeing an opportunity, but the question remains whether Europe can match the scale and depth of the US market.

How to finance the building and operation of data centres, the role of the owner/operator and tenant, and their requirements, and how to isolate risk are some of the important aspects of the future development of this important asset class.

GlobalCapital convened a panel of leading data centre developers, issuers, lawyers and investors – including Vantage – at its *GC Live* briefing in London in October to gather their insights on the opportunities, challenges and trajectory of data centre securitization in Europe.

Discussion participants



Moderator:
George Smith, head of securitization, *GlobalCapital*

Gordon Beck, managing director, securitised products solutions, Barclays

Guillaume Genin, senior director, capital markets, Vantage Data Centers

Wim Steenbakkers, managing director, global lead for satellite and technology, ING

Jeremiah Wagner, partner, global co-chair of structured finance, and global co-chair of fund finance, Latham & Watkins

GlobalCapital: Wim, could you set the scene by giving us a handle on the scale of the European data centre market, why it's growing so much and what's driving that growth?

Wim Steenbakkers, ING: Yes, I think there's a fabulous opportunity. We've been covering this business for about 15 years and we've seen

it grow from kilowatts per meter pricing to megawatt pricing today.

There seems to be no shortage of new opportunities, but we do see quite a difference in growth between certain regions around the world.

The availability of power and land are extremely important and hindering some of the markets. The US has accelerated enormously with super-large transactions compared

to Europe. In Europe, we are seeing growth pick up now.

The spend is about \$50bn on data centres today, growing to about \$90bn in five years, so that's exponential growth.

GlobalCapital: Who owns these data centres and why do they want to finance them? Jeremiah, how do you characterise the



ownership of Europe’s data centres at the moment?

Jeremiah Wagner, Latham & Watkins: You have two key components.

Where are the investors coming from? A lot of times, that has been driven by real estate-based investments and that’s been the initial focus.

Then there has to be an expertise in managing the centres themselves. There has to be the operational capability within the group.

So, you have the property element of it, which is one angle, and then you have the operational angle to it as well. You’ll see a number of strategies used as to how to structure that investment in both those sides of it.

Guillaume, I know you guys have your own views on that as well.

Guillaume Genin, Vantage Data Centers: The way we think about it from an ownership perspective is, first off, self-build versus third party-owned. A lot of our tenants are doing their own construction, on top of contracting with third parties such as Vantage.

Self-build brings a lot of pressure to the balance sheet from a capex perspective. Sometimes self-builders

just don’t have the expertise for specific regions or specific deployments. So, a lot of the growth has shifted away from self-build to third-party operators.

Within third-party operators, it is primarily private equity capital fuelling this. There are two notable publicly listed companies, Equinix and Digital Realty, but we’re certainly shifting away from public capital to private capital, especially for the large deployments that are just starting in the US but also as a generic trend that started before that.

For example, there was the take-private of QTS and CyrusOne a few years ago.

GlobalCapital: What do you see as the reasons driving the growth in demand for data centres at the moment, Guillaume? Is it all about AI or are there other factors as well?

Genin, Vantage Data Centers: You want to think about this in layers.

You still have the good old cloud growth. That is 15%-20% a year, depending on who you are asking, based on just an overall increase of the sheer amount of data being consumed and produced.

Then you have the AI layer. From a growth perspective, the AI layer

is mostly driven not from a supply point of view. Do you have the land and power and infrastructure to provide the deployment?

There are obviously large leases that have been entered into in the US.

The question is: can you actually replicate that infrastructure in Europe? I think the certainty you have on delivering on those large deployments as an operator is actually going to drive the growth of AI in Europe.

GlobalCapital: Just before we move on to discussing in detail how debt financing fits into this, it would be helpful to understand the asset a bit more and the lifecycle it goes through. How long does it take to build a data centre, how long can you run a data centre for and who is responsible for maintaining it?

Genin, Vantage Data Centers: I’ll take them one by one.

First, how long does it take to build a data centre? It’s roughly 18-24 months. It depends on how big the deployment is because there is only so much capacity that the tenant can absorb as they move in. If it’s a really large deployment, the ramp can be a little bit longer.

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Guillaume Genin, Vantage Data Centers



What people tend to underestimate is how long it takes to prepare the asset before you even put a shovel into the ground. You have to sort your permitting, your planning and you have to source your power. Sometimes you acquire old industrial facilities, so you will have to clean them up because that's mostly where the power is.

Then from an operational perspective, there are different ways to look at it. The general comment I would make is that the overall service that we provide is location and power. Those two things don't really depreciate.

It's important to note that the IT component of the data centre is the entire responsibility of the off-taker. They don't own those servers. Those have an obsolescence risk and may need to be replaced three or five years down the road, but that's not on our balance sheet.

To be complete, there is a bit of OFCI [owner furnished, contractor installed] that is part of the data centre. I'm thinking about large pieces of equipment such as chillers and backup generators. They typically have a 25-year useful life, depending on utilisation rate, but they represent a relatively small share of the overall costs of the data centre. The frame, the shell and core, and the steelwork are all very, very long term.

GlobalCapital: So, Gordon, as we think about a data centre in that context, what sort of financing would you want, when, and how does securitization fit into that?

Gordon Beck, Barclays: I'd bucket that into the three phases that Guillaume was describing.

The first is the prep work on the asset before you actually have a spade in the ground and start constructing. When you're speculatively purchasing land with the intent of acquiring power and permits, that's probably best suited to something in the private credit world or a relatively structured facility and, frankly, a relatively higher risk facility versus the kind of cash-flow debt financing that comes later in the piece.

The meat of the financing is done in that construction phase, because the meat of the capex is in that two-year span that Guillaume mentioned from spade in the ground to when the data centre is complete and operating.

In the construction phase, where you have power, permits and a lease, bank construction financing has, to date, generally been the most efficient financing option. Institutional investors can struggle with the frequency of drawdowns and the variability of what that can look like over that time. Banks have the flexibility for that.

At the latter end of the lifecycle, securitization becomes most applicable. Thinking about securitization more broadly, it's generally taking steady state credit cash flows and converting them into a note or a bond. A stable data centre is the point at which your cash flows start and that's where securitization can be most applicable.

I get these questions a lot: can you do securitization during the construction phase, or can you

have some construction risk in your securitizations?

Yes, you can have some, but you should certainly be thinking about that construction risk as having a relatively short remaining term; six months or maybe 12 months at the absolute outer limit. It should also be a relatively small proportion of your overall asset base, say, 10%-15%. The focus for the securitization should be the stabilised cash flow asset.

GlobalCapital: In terms of the data centres that are in Europe at the moment, are lots of them coming up to that point of stabilising? Is that why there's such a big opportunity? Are there lots of stabilised ones already? How come we haven't seen more than two deals?

Beck, Barclays: That's a question I certainly get a lot. It's a question I ask a lot as well.

The main reason is that point around the timing of stabilisation as Guillaume and others have referenced. Europe is, candidly, a few years behind the US in developing both the capital markets and the investment in this space.

What you have seen over the last 12 months and will see over the next 18 months is a wave of stabilising data centre assets from a number of different operators, which is why a lot more interested parties are in this room today than there would have been if we'd been thinking about this two years ago. Back then there was a much smaller pool of people with the scale that you need for securitization.

GlobalCapital: Wim, come in on when securitization would be most appropriate for a data centre compared to the alternatives. Talk us through the options once you've got for that stabilised asset.

Steenbakkens, ING: Various products can play a role at various stages during construction and development. We try to accommodate as much as we can during that time. We've been doing a lot of securitization in the US and we're a top-three player in that market.

The result of a lot of the regulatory differences we see between the jurisdictions is that the investor base in the US is a lot larger than in Europe at the moment.

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It is a question of when you decide to carve out your assets. If you're in a fast growth area, you may just want to wait and grow your portfolio and do the larger transactions.

The first one is the big one and then you set up the structure that you are going to have to live with for some time. While it can have quite a lot of flexibility with adding assets and the like, it is a run-up to putting that structure in place.

When that point is, maybe Guillaume can answer.

Genin, Vantage Data Centers: As most things are, it's linked to the equity strategy.

Taking Vantage as an example, we tend to sell assets when they achieve 'ready for service' status, though we still operate these assets seamlessly, at which point we would recycle the equity from construction equity to long-term capital.

At that point, when we sell those assets, we have a clean line of sight of who is going to own it, what's going to be their strategy, and what do they want in terms of debt product attached to that? Then it's easier to go to an investment bank and then start to have a discussion as to what's the most efficient piece of capital for that purpose.

Then ABS usually comes out on top because, the way I see it, it is a trade-off between a lot of structuring but against leverage and a very attractive pricing against such leverage. You can also pay dividends throughout. It's a bullet structure and it's a fixed rate, so you don't have to think about hedging for that period.

ABS has a lot of good features that are really attractive to those long-term investors, that make them and us decide that it is the long-term solution here.

GlobalCapital: Is it mostly the advance rate you're getting or is it also pricing in terms of ABS?

Genin, Vantage Data Centers:

I don't think about pricing in isolation because it's linked to risk, flexibility and leverage. What I would say is: if you look at the different institutional debt opportunities available right now, ABS is certainly the most efficient from a pricing and leverage balance at the moment.

GlobalCapital: We should talk about some of the risks involved in these deals.

Jeremiah, can you summarise what you see as the key risks for data centres?

Wagner, Latham & Watkins: To do an ABS, the way that we think about it generally is we try to isolate the specific risk the investors are going to invest in.

For data centres that really is around the property and, especially when you're looking at it in the ABS context, the cash flows that are coming off the stabilised leases at that point in time. Isolating those risks is the key thing that we think about. Outside of that, we want to make sure that we don't disrupt the operations or at least as little as we can.

That structuring phase can be a lot of work, but hopefully we can

isolate those specific risks without disrupting the company's normal operational processes in doing so. The company can continue to operate as it really wants to in operating within its longer-term strategies and really plan for that going forward.

What are we looking at in isolating those risks? We're really looking at ensuring the leases are there and that the cash flows off those leases will continue for what is going to be needed for the duration of the ABS bonds.

That requires looking at the terms of the leases and looking at the longer-term plan for any rollover of leases. It requires ensuring that the property is isolated away from the operational group to ensure not only that you have access to the property, but also to ensure that you can continue to operate the property such that the leases will continue to pay during that time.

That's how we look at it. It's about isolating specific risks and then focussing on those, rather than saying there is just a general risk to it.

What you're looking at is not the wider risk of the market maybe, but at whether over the duration of the deal, you will continue to receive those payments and what the risks are around the leases.

GlobalCapital: Gordon, you've structured two of these deals. How did you deal with some of those problems?

Beck, Barclays: Through a process of collaboratively understanding the business model of the operator, which fundamentally is quite similar across operators, but the precise manner in which they do things, the cadence in which they do them, where the decision-making sits, who makes the decisions, and when, will differ.

A lot of the nitty-gritty around getting these deals done in an effective manner is around some of the points that Jeremiah made but also some of the specific complexities in, for example, some of the leases.

The hyperscale tenants that underpin a lot of these transactions are very specific around public disclosure. The ABS market is a naturally public market so investors want all of the information. The tenants want to give no information, so somewhere in the middle we have to navigate to what works.

One of the parts that will continue to evolve with the market, and

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Jeremiah Wagner, Latham & Watkins





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“A stable data centre is the point at which your cash flows start and that’s where securitization can be most applicable”

Gordon Beck, Barclays



Vantage is a good example of this, is ensuring that operational flexibility to run the data centre is embedded within the ABS transaction.

Again, in an investor’s ideal world, decision-making from a pure ABS perspective would have no subjectivity. In reality, data centres are living, breathing objects effectively. A lot of people are involved in managing that and a lot of decisions to be made everyday. It’s actually in investors’ best interests to ensure that the operator can make those decisions in the right way in the right timescales.

Dealing with some of that operational flexibility within the transactions is also pretty critical.

GlobalCapital: Guillaume, do you want to add anything on this topic?

Genin, Vantage Data Centers: We’ve talked about the ABS product-linked risk.

On cash flow risk post-construction, it’s all about operating to the standards the hyperscaler requires under the lease. The main requirement is power uptime. That’s typically 99.99999% of uptime per year for cloud deployments that you need to achieve so you don’t breach your service-level agreement and have to pay rent credit as a result.

On top of that, you have to deliver within certain parameters in terms of temperature, pressure and humidity. Then you have physical security, no excuses there: everyone who is on site should have a reason to be there.

You have a very strict protocol as to who can access what room.

Obviously, the IT equipment is of extreme importance from a cyber security and hardware security perspective, so you need to ensure you have the proper processes to ensure that no breaches happen.

GlobalCapital: Gordon, does that operational complexity make it difficult to structure for the bankruptcy remoteness of the operator?

Beck, Barclays: Yes, in a word. That’s part of the reason why these deals are not straightforward to put together. I really like the way Guillaume describes the trade-off between upfront structuring work and the long-term platform that gives you an optimal combination of pricing and leverage.

The bankruptcy remoteness piece for ABS investors is obviously a key tenet of how we invest in transactions. The rating agencies in the space will also be very focused on that from the perspective of ensuring that if something happens to Vantage in this example, there is a process and a way for someone to be able to step in.

In the Vantage transactions, we’ve had a back-up manager who is appointed and effectively on hand ready to step in. They know the business and have been to visit the sites.

It’s a critical tenet of how to think about ABS investing and one of the key points in the structuring, for sure.

GlobalCapital: At the moment a lot of tenants are very highly rated, so it seems quite unlikely they will default, but if they did: Does the data centre itself have

re-let value or are there other ways to mitigate that risk?

Beck, Barclays: There are multiple ways to think about that risk.

You think about the likelihood of the tenant defaulting on all of its obligations.

You think about the likelihood of the tenant not wanting to continue to pay this specific lease in the context of a bankruptcy or a reorganisation of that tenant, for example. That’s one of the pieces of the underwrite from an investor perspective: how critical is this piece of infrastructure to their business?

Something like cloud computing scores exceptionally well from our perspective; that is the lifeblood of how Microsoft, Amazon and others are making money at the moment. That is exactly the type of asset they’re going to want to keep in a reorganisation.

Then you think about, exactly as you were saying George, if you are not able to keep that tenant in there, then what market is that data centre in and what is the availability of supply and demand in that market?

Generally, right now, that’s imbalanced, as Guillaume was saying. If you have supply, there is demand. The medium term for that is where people are probably focused, but in the short run, there clearly is demand in key markets. The re-leasing piece is another layer of protection for investors.

One further thing I would add is a lot of these ABS transactions are on stabilised assets now where the lease was signed perhaps two or three years ago. In the interim, data centre lease rates have grown 10% a year, something like that, so you also have a lease which is actually 30% less than a tenant would need to pay for a similar asset now. That gives you more confidence on that re-leasing as well.

Steenbakkens, ING: One piece that we didn’t really touch on is location.

Location is actually quite important, especially in the eyes of some of the hyperscalers. They work in availability zones which define the service level agreements they can grant to their users.

From a lending perspective, one of the mitigants here is the location. If you’re not in those tier 1 or tier 2 locations, the strength of the hyperscale contract or the enterprise contracts in general are the key mitigants.

GlobalCapital: One of the other things that comes up is the risk of the technology moving very quickly; new Nvidia chips coming out every two years or that kind of thing. Is that a problem for these stabilised data centre leases that we've been discussing?

Steenbakkers, ING: Arguably it isn't something to worry about because that's a risk of the tenant. For those local enterprise players, it might be different, but for hyperscale contracts, the tenants are responsible for the cleanroom's inner workings.

Beck, Barclays: I agree. I look forward to discussing that risk at the *GlobalCapital* seminar on GPU ABS in four years' time, but for data centre securitization, it's not a key issue.

GlobalCapital: Jeremiah, is there anything you'd add to what we've mentioned so far?

Wagner, Latham & Watkins: I would make one point. I was interested in some of the earlier conversation around what is driving the growth in Europe versus the US, which is a little bit distinct.

One of the things we've often seen is a lot of the growth in Europe being driven by countries wanting their own digital infrastructure. That's a big movement and I think that's driven on a geopolitical basis.

The US is one jurisdiction at the end of the day, compared to what we're now seeing in Europe, which is a lot of countries looking at ways in which they can build data centres and have those as key infrastructure.

I'm curious, Guillaume, how much that impacts some of that early planning where you can secure power, you can secure land, when the jurisdictions are looking for that as a key piece of their own ongoing infrastructure?

Guillaume Genin, Vantage Data Centers: It's really important. I'll answer with an example. A few weeks ago, Vantage was recognised under Article 13 by the Italian government as an organization that is carrying out projects of significant national interest.

What that Article 13 designation allows you to do is instead of going through the normal chain

of command, you have a third party appointed that will look at your application and if it meets the criteria, it will be approved within a few days.

GlobalCapital: We have time for just one audience question.

Andrew Currie, Fitch Ratings: Just back to the point of Nvidia releasing a new chip every two years. We do not have specific exposure to Nvidia or the chips, but is there a chance that the chip they introduce in five years' time is not suitable for the property that we have?

Genin, Vantage Data Centers: I think it's more the other way around. The property that we have designed and operate in our fleets in Europe is typically at a specs level that is superior to what you need to operate AI chips. One element is, for instance, density. You need smaller footprints to power the same amount of megawatts if those are consumed by AI chips versus the previous cloud hardware.

As a result, the data centres that we purposely built for AI may be smaller in footprint. They may also be less resilient in terms of power redundancy because AI models can allow for more power downtime and still be able to run in a way that doesn't alter the performance of their model.

You can look at various parts of those specs but essentially what it translates into is a lower cost to build.

The way to think about it is you could retrofit if you want to go from the existing cloud fleet into

AI-purposed specs. The other way around is less true.

Beck, Barclays: The other point I would highlight for ABS investors is, again, that risk doesn't sit with stabilised cash flow assets that are on long-term leases to the tenants because the tenant is paying for the power and the space. If the tenant doesn't have the right chip to use in that space, I agree, it's a wider ecosystem issue and maybe it's an equity issue, but for the precise risk that the ABS investor faces, it's not.

Genin, Vantage Data Centers: That's a good point. The lease cash flows are payable as long as we meet the requirements under the lease. Those requirements are not changing based on what type of chip the tenant is using.

Beck, Barclays: They might try but they're not allowed.

Steenbakkers, Latham & Watkins: That's relatively easy to do. If you want to move to a different cooling technology, and there are various ones around, that is not super costly. Certainly, if you've built to the highest spec today, you should be able to accommodate.

Genin, Vantage Data Centers: The way we think about that from an equity perspective is that it is upside if they come back to us and say: 'Hey, you know what, I would like to tweak that part of the design'. We can accommodate that. If that's going to cost incremental capex then we'll just have to discuss economics concurrently. ©

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Wim Steenbakkers, ING

