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Financing and Debt Issuance for Data Center Developers: Insights from Womble Attorneys

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Data center developers face a myriad of challenges when it comes to financing and debt issuance. In this blog post, Womble Of Counsel Barlow Keener delves into the intricacies of these topics with Womble Of Counsel David Beckstead and Womble Of Counsel Art Howson. The conversation covers essential aspects such as project finance models, revenue streams, and risk management. This comprehensive discussion aims to provide valuable insights for data center developers looking to enhance their financial strategies.

Barlow Keener: David, what are the primary considerations for data center developers when it comes to debt financing?

David Beckstead: When considering debt financing for data centers, it is crucial to understand that lenders are primarily interested in the project's revenue streams and risk profile. They look for an acceptable return given the risk involved, and this includes examining co-location agreements, tenancy agreements, and the overall financial model. Lenders scrutinize the project's utility supply, including power and water, and the potential impact of delays or downtime on revenue. Additionally, lenders are interested in the project's location, proximity to power and water infrastructure, and the availability of fiber cables.

Barlow Keener: How do lenders assess the risk associated with data center projects?

David Beckstead: Lenders assess risk by evaluating various factors such as the project's revenue streams, the creditworthiness of tenants, and the terms of service level agreements. Lenders are particularly interested in the service level agreements ("SLAs"), which outline minimum downtime and construction delay provisions.

Barlow Keener: Can you explain the concept of limited recourse financing in the context of data centers?

David Beckstead: Limited recourse financing means that the data center project's assets are used to secure the lending, and the revenue streams are what lenders rely on for repayment. This model is common in project finance and is particularly relevant for data centers due to their unique infrastructure requirements.

Barlow Keener: What role do green loan principles play in data center financing?

David Beckstead: Green loan principles, such as those issued by Loan Market Association ("LMA"), the Asia Pacific Loan Market Association ("APLMA"), and the Loan Syndications and Trading Association ("LSTA"), are increasingly important in data center financing. These principles require data center operators to maintain certain energy and environmental design standards, which can make the project more attractive to lenders. Data center operators are expected to adhere to standards such as LEED certification, which focuses on energy efficiency and environmental sustainability.

Barlow Keener: Moving on beyond green loan principles, Art, how do lenders approach the construction phase of data center projects?

Art Howson: During the construction phase, lenders often require completion guarantees and financial support from sponsors, including minimum equity contribution requirements for the project. From a due diligence perspective, they typically review the project construction schedule closely in comparison with terms of the project's revenue contracts, and structure the loan documents to mitigate the risk of potential delays or cost overruns.. Lenders may also require reserve to maintain funds on deposit to cover loan payments or other project costs.

Barlow Keener: Art, what are the key elements of a co-location agreement that lenders focus on?

Art Howson: Lenders focus on the terms of the data center's revenue contracts, including the length of the lease, early termination risks, and the creditworthiness of tenants. They typically seek the ability to cure defaults under key project contracts, to protect their interests in case of default and ensure that the project's revenue stream remains intact. And they will want to confirm that the tenancy agreements can be assigned to a new project owner if necessary, given the importance of those contracts as collateral for the loan.

Barlow Keener: How do lenders evaluate the supply of utilities for data center projects?

David Beckstead: Lenders evaluate the supply of utilities by examining the project's power and water infrastructure. Lenders to data centers today are more than ever particularly interested in how power is secured, whether through dedicated power purchase agreements ("PPAs") or other arrangements, as this is a critical factor for data center operations. Lenders will also assess the project's proximity to power plants and water sources to ensure reliable utility supply.

Barlow Keener: Art, what are the common risk allocation strategies in data center financing?

Art Howson: Common risk allocation strategies include limitations on the amount of debt that can be advanced, in relation to equity contributions or to the projected value of the project. Lenders may also require the project to have payment and performance bonds in place with the key construction contractors and equipment suppliers, to mitigate risks outside of the borrower's direct control.

Barlow Keener: In conclusion, financing and debt issuance for data center developers require a thorough understanding of various financial models, risk assessment strategies, and contractual terms. By focusing on revenue streams, utility supply, and green loan principles, data center developers can enhance their financial strategies and secure the necessary funding for their projects. The insights provided by Womble Of Counsel David Beckstead and Womble Of Counsel Art Howson offer valuable guidance for navigating the complexities of data center financing. As the data center industry continues to evolve, staying informed about these critical aspects will be essential for success.

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