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Securitized Products Special Topics

Power Costs: Data Centers and Recovery Bonds Poised for More Predictability

Utility Provider Agreements Can Stabilize Deal Cashflows

The intensifying effort to contractually settle who pays for electricity infrastructure construction and upgrades should inject more cashflow predictability into both data center deals and recovery bonds. Power companies, public utilities commissions, data center developers/landlords, and other stakeholders are hard at work on inking agreements that allocate grid improvement costs. A notable recent example is AEP Ohio's new pact. The agreement requires large new data centers to pay for a minimum of 85% of the energy they say they need each month, even if they use less. In Texas, grid operator ERCOT and the state's public utility commission are considering related moves, according to press reports.

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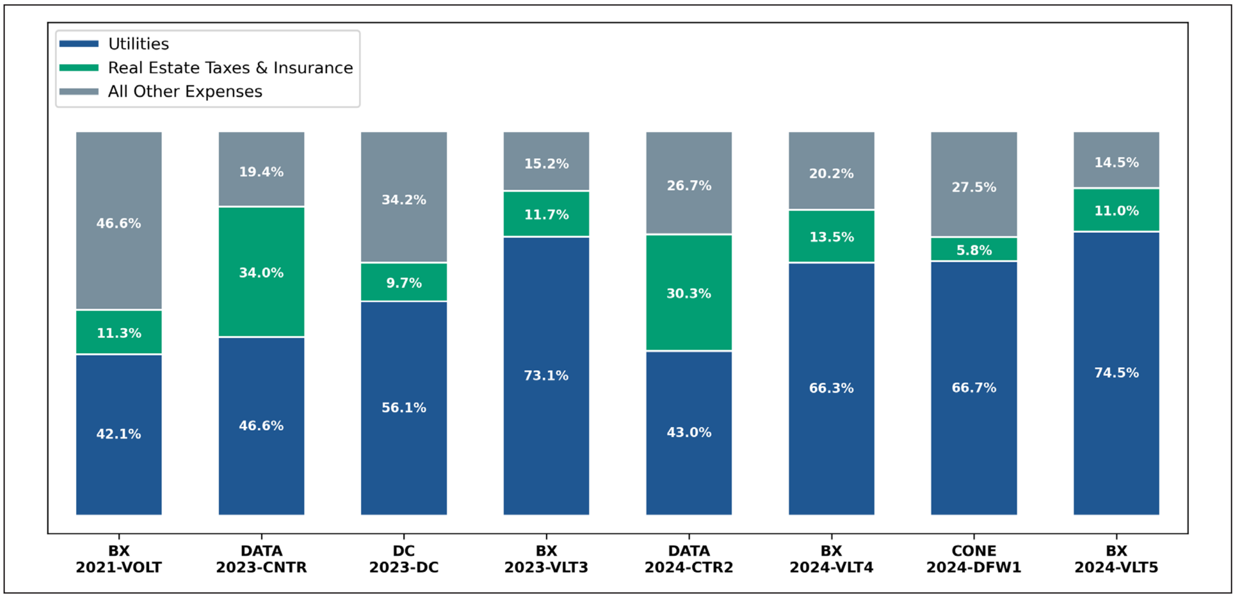
Such agreements could affect the cost structures of data centers in markets such as Columbus, OH, and Dallas, TX, two of the fastest growing data center hubs in the US. Power costs represent the largest chunk of properties' operating expenses (Figure 1). To be sure, data center landlords may be able to pass utility costs to tenants. But agreements such as AEP Ohio's, that set clear, perhaps more predictable thresholds on utility costs, may ease investor underwriting and cashflow modeling amid a surge in data center electricity needs.

Figure 1. Data Center Operating Expense Breakdown



Source: Deal documents and Academy Securities

Power costs vary as the data center sector de-clusters

Power availability and energy costs are emerging as a key parameter impacting data center properties performance. Deal documents and presales emphasize low-cost markets as significant credit positive. For example, CONE 2024-DFW1 notes Texas' "inexpensive power" supports the pool's DFW1 colocation data center in Carrollton, TX. In turn, in SWCH 2025-DATA the Las Vegas and Reno, NV, underlying properties benefit from "favorable" power rates in the Mountain region, according to the deal's presale.

Investors may increasingly distinguish across data center exposures based not only on aspects such as property category ([hyperscale vs. colocation][1]) or [operator strength][2], but also based on grid robustness and local utility actions. For example, utilities are now more selective in Purchase Power Agreement (PPA) approvals, using thorough intake forms and application fees, according to JLL. In Texas, the Governor called for a review of all policies concerning the grid, amid ERCOT's electricity demand growth projections. The utility noted that to keep up with soaring energy needs in Texas, by 2030 the state's grid will need to support on peak days almost double what it can currently handle. Data centers account for a big chunk of that projected demand. In a similar vein, AEP expects electricity demand in Central Ohio to more than double by 2030, driven largely by data centers.

Power-driven property distinctions become more relevant as the data center sector continues to "de-cluster". Investors can now gain exposure to properties beyond just the Northen Virginia market. Even as the area's two major submarkets, Ashburn and Manasass, remain the most dominant data center hubs, securitized data center deals include a widening range of other primary and secondary hubs (Figure 2).

Figure 2. CMBS Data Center Geographic Exposure

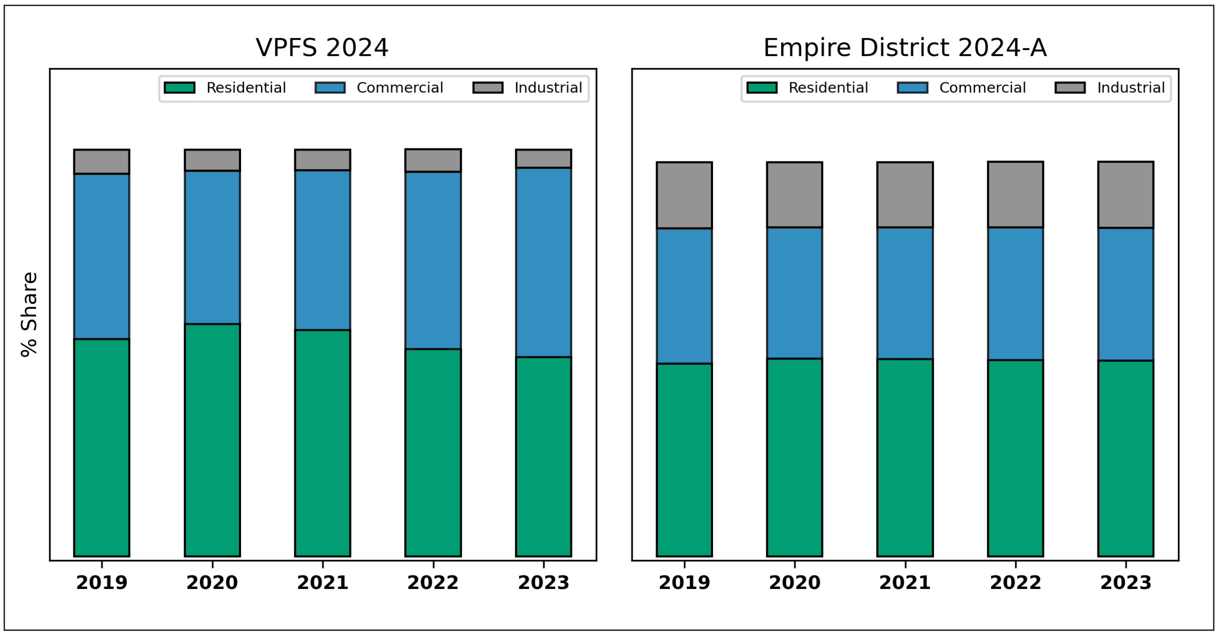
Source: Deal documents and Academy Securities

1 "Data Centers: A Strong Segment Juggles ABS and CMBS," Securitized Products Special Topics, Academy Securities, October 4, 2022
2 "Data Centers: Performance Wrinkles to Test Operators' Role," Securitized Products Special Topics, Academy Securities, February 21, 2024

Agreements could lower ratepayer bonds performance volatility

Data center cost allocation policies and agreements across various service areas may also help lower volatility of utility fee collateral. Elevated exposure to commercial and industrial customers can introduce performance uncertainty on ratepayer securitization or recovery bonds, as we discussed in a previous report.[3] The electric consumption of such commercial customers is typically less stable than residential consumption. Utility firms also note that residential sales have a much higher margin compared to industrial and commercial customers. Some ratepayer deals have significant exposure to non-residential customers (Figure 3).

Figure 3. Utility Fee Issuers Sales Revenue by Customer Class



Source: Deal Documents, Ratings Agencies, and Academy Securities

Commercial consumption can vary either because (1) customers can adjust their usage in response to economic conditions, or (2) business-driven relocations of commercial customers away from the utility service area. Data center operators increased implementation of "load shifting" rather than reliance on "steady state" operations could exacerbate commercial consumption volatility. In a steady state operation, data center energy consumption is fairly stable. In load shifting, data center operators may dynamically shift workloads across different geographies based on grid capacities. Interestingly, the AEP Ohio agreement will also require developers to pay an exit fee if their project is canceled or unable to meet the obligations outlined in the electric service agreement contract.

3 "Recovery Bonds: Diversifying Exposure Moves Beyond Disasters," Securitized Products Special Topics, Academy Securities, February 7, 2024

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