

Market Musings 10/26

For Professional Investors only

Not all data centres are created equal

Beyond the political noise: electricity, location and interconnection

The public debate around data centres is increasingly dominated by electricity consumption, land use and the political backlash against new development. With the US midterm elections approaching, the noise gets louder. Investors, however, should be asking a different question: what type of data centre is most likely to capture the value of an increasingly AI-driven economy?

Electricity, electricity... location

Not all data centres are created equal. As AI drives demand for more computing capacity, what matters is where that capacity is being added: the strongest assets sit in locations where power, users, fibre connectivity, cloud providers, telecom operators and enterprise customers come together.

At Van Lanschot Kempenn, we have adapted the old real estate motto for the digital age: electricity, electricity... location. The order is deliberate. A data centre needs sufficient, deliverable electricity first. From there, the quality of the location determines who can connect, what the facility can reach and, ultimately, how difficult it is to reproduce.

AI makes that definition of location more valuable. Training large models can be concentrated where power is abundant; inference and enterprise use put a premium on moving data quickly and securely between users, clouds, models and storage environments. Location, in this sense, is the combination of proximity to demand, fibre connectivity and access to the digital ecosystem customers actually need.

Interconnection turns a data centre into a great data centre

Interconnection is where value hides. The more customers, cloud providers and telecom operators are connected within a facility, the more useful that facility becomes to everyone already there and to the next customer considering it. That network effect is the real value-add: customers want to be where the counterparties and platforms they need are already connected, while moving elsewhere means rebuilding connections, security arrangements and operating processes. In other words, the best-connected facilities attract customers and become increasingly difficult for them to leave.

For investors, the benefits show up in pricing, retention and resilience when new capacity enters the market. The physical capacity may be replaceable; the network of customers, clouds and carriers around it is far more difficult to recreate. Megawatts can be built quickly, while ecosystems take years.

The best-connected facilities attract customers and they become harder for them to leave

The question the market is missing: who pays?

The political debate also tends to treat data-centre electricity demand as though it has the same impact everywhere. It does not. In the United States, over 20 states already separate the tariffs paid by large-load customers from those paid by residential customers, while several more are discussing such a distinction. Where those tariffs allocate a larger share of fixed system costs to large-load customers, data centres can have a materially different impact on household bills, and in some cases large-load customers may effectively subsidise residential customers through their contribution to those fixed costs. This distinction rarely features in the political debate.

The political backlash ultimately comes down to who pays. If households absorb more of the grid or power costs associated with new data centres, resistance can translate into tougher permitting, delays or moratoriums; if large-load customers carry more of those costs themselves, the incentives are very different. Once the election noise fades, this regulatory distinction in how costs are allocated should become far more important.

Where fundamental investing earns its keep

The market likes simple numbers, and megawatts are wonderfully simple. The investment case is not. Lasting value depends on the quality of the location, the depth of the interconnection ecosystem and the regulation that determines who ultimately pays for the power infrastructure around it.

That is where fundamental portfolio management can add value: separating capacity from quality, political noise from economics, and replicable data centres from those that customers actually need to be in. Not all data centres are created equal. Investors should not value them as if they were.

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