Insights

# FINANCING DATA CENTRE DEVELOPMENTS: BALANCING RISK AND OPPORTUNITY IN A CAPITAL-INTENSIVE SECTOR

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SUMMARY

*This is the second in a ten-part article series on the legal strategies shaping the future of data centre development in the UK.*


The United Kingdom’s data centre sector is built on a striking paradox: demand for digital infrastructure seems limitless, but building it requires eye-watering amounts of capital. A hyperscale facility can cost more than £500 million, putting data centres among the most capital-intensive real estate assets in the world.

In this high-stakes environment, financing is not just about securing capital. It’s about designing the right capital structure – balancing debt and equity in a way that reduces risk, satisfies lenders, equity partners and tenants, and still delivers long-term returns.

In this third instalment of our Insight Series, we look at how sophisticated financing structures are used to balance risk and opportunity in the UK data centre market and share practical advice to help developers navigate complexity with confidence

## BUILDING THE CAPITAL STACK

Data centre finance is rarely a simple debt-versus-equity decision. Instead, developers assemble a "capital stack," a multi-layered mix of funding sources, each with its own risk profile, cost and set of legal rights. The right blend depends on the project stage and the level of risk investors are prepared to take.

### SENIOR DEBT: THE FOUNDATION

Senior debt, typically provided by major commercial banks and institutional lenders, forms the backbone of most data centre financing. It’s the cheapest source of capital, but comes with strict conditions.

Lenders focus on repayment certainty, which hinges on long-term, predictable income from tenant leases. To protect themselves, they impose covenants such as Debt Service Coverage Ratios (DSCR), which require income to exceed debt payments by a margin (e.g., 1.25x), and leverage ratios such as Loan-to-Value (LTV) and Loan-to-Cost (LTC), which limit the amount of debt relative to the asset's appraised value and development cost. These terms are heavily negotiated: developers need flexibility, while lenders demand assurance. Banks are cautious about construction and leasing risk .Speculative or partly pre-let developments often face tighter equity requirements and phased loan drawdowns linked to leasing milestones. The UK's grid connection challenges add another layer of complexity. Although Ofgem and NESO's recent reforms, such as the TMO4+ model expected in Autumn 2025, aim to improve certainty, lenders will scrutinise a project's grid queue position and connection agreement before committing.

## MEZZANINE DEBT AND PRIVATE CREDIT: BRIDGING THE GAP

Because senior lenders are conservative, developers often turn to mezzanine or private credit to bridge funding gaps. Provided by specialist funds, this debt sits between senior loans and equity – costlier, but more flexible.

Mezzanine loans are more expensive than senior debt but offer greater flexibility. They can be used to increase overall leverage, bridging the gap between the senior loan amount and the required equity contribution. This can be particularly valuable for funding pre-construction activities, such as land acquisition or securing long-lead procurement items, before the conditions for drawing down the senior facility have been met. However, mezzanine loans are structurally complex. They often defer interest payments through "payment-in-kind" (PIK) structures and may include equity kickers, such as warrants or profit participation. These tools help developers preserve cash flow during construction while offering lenders upside potential. But having multiple creditor classes requires complex intercreditor agreements.

### How we can help

We have extensive experience in negotiating intricate loan agreements. Working closely with our clients, we create a stable and workable relationship between all parties in the debt structure.

## EQUITY CAPITAL: THE ENGINE OF GROWTH AND RISK

Equity is the highest-risk, highest-return tranche of the capital stack. Equity investors range from private equity funds seeking opportunistic returns to pension funds and sovereign wealth funds seeking stable, inflation-linked income.

For most developers, bringing in an equity partner is essential. This is typically structured as a joint venture. The negotiation of the JV or shareholder agreement is a critical legal process that defines the relationship between the partners. Key areas of negotiation include the "waterfall" provisions, which dictate how profits are distributed after debt service and other expenses are paid, and governance rights, which determine how the project is controlled. This includes board representation, a schedule of reserved matters requiring the consent of both partners, and deadlock resolution mechanisms.

Crucially, the agreement must also provide for clear exit strategies, such as "drag-along" rights (allowing a majority shareholder to force a sale of the entire company) and "tag-along" rights (allowing a minority shareholder to join in a sale initiated by the majority).

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## MAKING PROJECTS BANKABLE

Access to finance depends on reducing construction, grid and revenue risk.  Legal structures play a central role in this, making projects attractive to investors and lenders.

### CONSTRUCTION AND GRID CONNECTION RISK

For lenders, delays, cost overruns or delivery failures are unacceptable. Fixed-price, date-certain EPC or development management contracts are therefore essential. These agreements, backed by performance bonds and parent company guarantees, give lenders confidence that contractors will deliver.

- Grid connections remain a major bottleneck, because lenders will not fund projects with uncertain connection dates. The Ofgem/NESO reforms aim to prioritise “ready” projects, but success depends on developers presenting robust applications. Grid connection agreements are closely scrutinised to cap costs and hold network operators accountable.

### REVENUE RISK: LEASES AS FINANCIAL INSTRUMENTS

Once operational, the risk profile of a data centre shifts from construction to revenue generation. The source of this revenue, the lease agreement, is therefore the single most important document for any long-term lender. A long-term lease to a hyperscale tenant with an investment-grade credit rating (such as Amazon, Google, or Microsoft) transforms the data centre from a piece of real estate into a quasi-financial instrument. For lenders, this "hyperscale-backed" income stream is similar to a long-dated corporate bond, providing a highly predictable source of cash flow to service the debt. Lenders prefer terms with no break clauses, long durations (15–20 years) and fixed or inflation-linked rent reviews.

By contrast, colocation or speculative facilities with multiple tenants on short leases are riskier. Lenders respond by demanding more equity, higher interest margins, and protections such as debt service reserve accounts. To finance such projects, developers must provide a larger equity cushion. They may also be required by lenders to establish a dedicated debt service reserve account (DSRA), typically holding 6-12 months of debt service payments, to provide a buffer against rental voids.

## THE GROWING INFLUENCE OF ESG ON DATA CENTRE FINANCE

In recent years, Environmental, Social, and Governance (ESG) has moved from being a “nice-to-have” to a decisive factor in accessing competitive capital. For a sector as energy-intensive as data centres, a credible ESG strategy is no longer optional.

As a result, green finance is growing fast. Green loans and bonds are financing instruments where the proceeds are specifically earmarked for projects with clear environmental benefits, such as a data centre designed to achieve a BREEAM "Outstanding" rating and powered by 100% renewable energy. In contrast, sustainability-linked loans (SLLs) are more flexible. The loan can be used for general corporate purposes, but the interest rate is tied to achieving ESG targets such as low power usage effectiveness (PUE), renewable energy sourcing or reduced water use. Lenders and institutional equity partners now conduct their own rigorous ESG due diligence. This includes assessing a project's alignment with frameworks such as the EU Taxonomy for Sustainable Activities and the UK's net-zero trajectory. Strong ESG performance not only lowers risk, but can also directly reduce the cost of capital and widen the pool of available investors, many of whom are now operating under their own mandates to deploy capital into sustainable assets.

## STRUCTURING FOR RESILIENCE

Financing a data centre in the UK market is a complex, multi-layered discipline. It demands a holistic approach that seamlessly integrates legal expertise across finance, real estate, construction, energy and regulation. The optimal financing structure is one that not only secures the necessary capital at a competitive cost, but also provides the resilience to withstand market volatility and the flexibility to adapt to technological change.

### How we can help

We bring a unique, cross-practice perspective to the table, drawing upon our market-leading knowledge and experience in structuring finance for other complex infrastructure assets. Our integrated, cross-practice team provides the strategic guidance necessary to navigate complexity with confidence and at pace. Working closely with developers and investors, we structure financing solutions that are not only bankable, but aligned with their long-term commercial objectives. In doing so, we're empowering our clients to build the critical digital infrastructure of tomorrow.

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