# London Borough of Hammersmith & Fulham

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| **Report to:** | Pension Fund Committee |
| **Date:** | 23 July 2024 |
| **Subject:** | Data Centres Opportunity |
| **Report author:** | Siân Cogley, Pension Fund Manager |
| **Responsible Director:** | Phil Triggs, Tri-Borough Director of Treasury and Pensions |

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## Summary

The purpose of this item is to provide the Committee with an introduction and overview of an investment opportunity in property data centres.

## Recommendations

The Committee is requested to consider an allocation of pension fund assets to data centres.

## Wards Affected

None.

## LBHF Priorities

| Our Priorities | Summary of how this report aligns to the LBHF priorities |
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| • Building shared prosperity | Being an outperforming investor means that as part of the Pension Fund's fiduciary duty, its investments should be able to assist in making a positive financial contribution, sharing prosperity and lessening the financial impact on council taxpayers. |

## Financial Impact

The financial implications of these investments will be continually monitored to ensure that members' pensions are safeguarded. There is no direct financial impact as all costs and returns are segregated within the Pension Fund.

## Legal Implications

None

**Asset Class Review**

**1. Background**

1.1. Data Centres are large industrial buildings, designed to house racks of computer servers for the storage of data and connecting internet traffic. They are an increasingly critical component of corporate and consumer dependence on technology.

1.2. The hyperscale data centre market size is projected to more than double in the next five years. Q4 2023 saw the strongest historical leasing activity globally.

1.3. This asset class is an alternative to traditional real estate and infrastructure investments. The portfolios are designed to produce returns primarily from rental payments (based on power capacity rather than traditional leases) and asset sales.

1.4. Investments can offer higher returns, given the specialised nature of data centres and a favourable demand/supply imbalance seen in the property market.

1.5. In terms of the tenants, operators run and lease the data centre capacity to the various users. Funds can target hyperscale cloud service providers, including AWS, Google and Microsoft.

1.6. These companies consume large quantities of data centre capacity and tend to have very high credit ratings, making them high quality tenants.

**2. Investment Strategy**

2.1. The key benefits and risks of the strategy set out by data centres are set out below.

**Benefits**

- Long-term stable cash flows with inflation-linked returns.

- Diversification is unique and has low correlation of returns relative to both other property sub asset classes and traditional asset classes like equities and fixed income.

- High credit quality of clients, accelerating demand and longer, healthier tenancy agreements.

**Risks**

- Underlying assets are illiquid and cannot easily be sold on the secondary market.

- The asset class is still relatively new and untested relative to other mainstream asset classes, with few asset managers in the market.

- Assets are not immediately operational with time taken to deploy capital and develop sites, carrying risk of time and cost overrun or constructor default.

## 3. Next Steps

3.1. The committee should consider this asset class. If data centres are deemed an attractive opportunity, and one which the Committee wishes to pursue further, proposed next steps are:

- Consider opportunities within the Fund's current investment portfolio where an allocation could potentially be implemented, and model potential alternative allocations.

- Consider the impact on the Fund's risk versus return characteristics, overall portfolio liquidity, cashflow profile, fees and wider ESG and impact considerations.

- Consider investment propositions within the data centres market and present these to the Committee for further attention.

## 4. Risk Management Implications

4.1. Risks are outlined in the report.

## 5. Other Implications

5.1. None.

## 6. Consultation

6.1. None.

**List of Appendices:**

**Appendix 1** – LBHF – Data Centres Initial Briefing Paper – April 2024