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Global Software + US Communications Infrastructure

Decoding Datacenter Contracts: Key takeaways and transcript from our discussion with a legal expert



Mark L. Moerdler, Ph.D.
+1 917 344 8506
mark.moerdler@bernsteinsg.com



Madison Rezaei
+1 917 344 8622
madison.rezaei@bernsteinsg.com



Firoz Valliji, CFA
+1 917 344 8316
firoz.valliji@bernsteinsg.com



Shelly Tang, CFA
+1 917 344 8342
shelly.tang@bernsteinsg.com



Nancy Wu
+1 917 344 8545
nancy.wu@bernsteinsg.com

Given the amount of interest from last year's datacenter contract webinar and the amount of scrutiny on these contracts recently, we hosted another discussion with the same legal expert one year later to see what has changed and what remains the same (replay link). Our key takeaways include:

Regulatory change is primarily at local rather than national level. While it's emerging as a bottleneck power remains the biggest near-term constraint for development.

Power availability and timing remains the key driver of winning a contract: Having accessible power within 12mo is a platinum asset whereas >48 months is commercially unattractive. A 400MW site can still be highly valuable if 100MW arrives within 12–24 months with a credible path to the remainder.

Large deals are highly bespoke. While termination-for-convenience is unacceptable, acceptable cancellation rights generally relate to loss of the power pathway or failure to meet defined development milestones. Leases may also impose delay remedies such as free-rent credits or liquidated damages. Optionalities such as expansion rights, right-of-first-refusals, purchase options, and extensions options are all key negotiating points.

Credit support is critical for neoclouds. Neocloud deals rarely close without credit enhancement, which includes upfront cash, letters of credit, guarantees, or support from AI/chip companies. However, the market has shifted from 100% guarantees toward limited support e.g. covering ~80% of construction debt rather than the full obligation. Since guarantees amortize linearly, thus reducing the protection over time, while guarantors increasingly seek step-in rights to take over space and power.

Key contractual "gotchas": Watch for buried termination-for-convenience clauses, inadequate or rapidly amortizing credit support, lease transfers that eliminate credit protection, and excessive tenant control over future expansion, contraction, or campus development.

What happens if a neocloud fails? Which could happen in the next 1–3 years due to mismatch between a longer data center lease vs. much shorter customer contracts. However, strong upfront credit support can protect owners if the tenant fails and the facility is recovered promptly, and the capacity can be offered at a very competitive rate.

Demand remains strong: There is no visible slowdown in deal activity, although underwriting is becoming more disciplined. Longer term, demand should broaden from remote training campuses toward smaller urban and suburban inference facilities over the next 3–5 years.

See the Disclosure Appendix of this report for required disclosures, analyst certifications and other important information. Alternatively, visit our Global Research Disclosure Website.

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BERNSTEIN TICKER TABLE

			29 Oct 2026		TTM		Adjusted EPS			Adjusted P/E (x)		
Ticker	Rating	Cur	Closing Price	Price Target	Rel. Perf.	Cur	2025A	2026E	2027E	2025A	2026E	2027E
MSFT (Microsoft)	O	USD	530.14	722.00	(14.1)%	USD	17.28	20.63	25.85	30.7	25.7	20.5
ORCL (Oracle)	O	USD	139.56	325.00	(61.3)%	USD	7.63	8.37	12.19	18.3	16.7	11.5
EQIX (Equinix)	O	USD	1,036.67	1,270.00	17.9%	USD	14.96	18.38	20.12	69.3	56.4	51.5
DLR (Digital Realty)	O	USD	182.91	226.00	(2.6)%	USD	3.87	3.09	3.21	47.2	59.1	57.0
BXDC (Blackstone Digital Infra)	O	USD	16.22	26.00	NA	USD	0.00	0.32	(1.00)		50.8	(16.2)
CSQR (Csquare)	O	USD	14.95	27.00	NA	USD	0.00	(1.34)	(1.06)		(11.1)	(14.1)
AMT (American Tower)	O	USD	185.88	221.00	(8.2)%	USD	5.40	6.95	6.90	34.4	26.8	26.9
CRWV (CoreWeave)	U	USD	60.74	54.00	(68.6)%	USD	(1.20)	(5.14)	(6.60)	N/M	253	32.1
SPX			7,720.39									

O - Outperform, M - Market-Perform, U - Underperform, NR - Not Rated, CS - Coverage Suspended

CRWV valuation is EV/EBIT (x); MSFT, ORCL base year is 2026;

Source: Bloomberg, Bernstein estimates and analysis.

INVESTMENT IMPLICATIONS

Global Software: We are Outperform on Microsoft and Oracle and this discussion was in-line with our thesis.

U.S. Communications Infrastructure: We are Outperform on AMT, BXDC, CSQR, DLR, and EQIX. We are Underperform on CRWV.

DETAILS

KEY TAKEAWAYS

We recently held a conversation with Jeffrey Moerdler[1],a real estate lawyer specializing in data centers and digital infrastructure, to discuss the in's and out's in a datacenter contract, and what has changed over the past year. Our key takeaways include:

- **Regulatory change** in the US is primarily local rather than national. Power availability remains the most constraining factor near term, but community acceptance and changing rules have also become major concerns. Developers must assess not only whether a site works under current rules but also whether local requirements may change before the project is completed.

- **Power:** The value of powered land depends on the timing of power availability and a reliable path to obtaining it. Power available <12mo = platinum asset; 12-24mo = gold asset; 24-48 mo = silver; and >48 mo is generally not commercially attractive. A site planned for 400MW can still be highly valuable if 100MW will be available within the first 12 to 24 months and the remaining capacity has a credible pathway. Responsibility for obtaining power varies by transaction.

- **Lease structure:** every large deal (e.g. >100MW) is bespoke, but we discussed several key aspects of these contracts:

  - **Hyperscalers** typically insist on their own lease forms that are customized and favorable to their own benefit. These forms often contain termination-for-convenience rights to start with that are generally used as negotiating leverage for other optionality, but termination for convenience should never be accepted and if overlooked can be very risky (even though it still occurs). Historically there hasn't been much termination for convenience included as it should have been taken out of the final contract.

  - **Optionality** could include expansion rights for space and power, rights of first refusal, purchase options, and extension options etc. Less sophisticated or financially pressured developers may accept many of these terms because they value the tenant's investment-grade credit and recognizable name.

  - **Acceptable cancellation rights** generally relate to loss of the power pathway or failure to meet defined development milestones. Some agreements provide extension and force majeure rights, and some allow termination only if the outside completion date is missed rather than for every intermediate milestone. Leases may also impose delay remedies such as free-rent credits or liquidated damages. The precise remedies depend on deal size, customer type, and negotiating leverage.

  - **Neocloud credit enhancement**: Credit support is especially important in new neocloud datacenter developments, and it's extremely rare to complete a neocloud deal today without a credit wrapper, which includes an upfront cash contribution, a letter of credit, a limited guarantee or support from an AI or chip company.

  - **Credit support shifting to <100% guarantees:** The market has shifted over the last year from full lease guarantees toward limited guarantees, and this is happening across different guarantors including hyperscaler, AI companies and chip companies. Nowadays, guarantor may cover 80 percent of a construction loan but not all rent under the lease vs. previously 100%. The developer must fund the remaining equity above the construction loan. Guarantees also commonly amortize on a straight-line basis over the initial lease term, meaning a guarantee supporting a 10-year lease may have little value left by year 7 or 8. This is happening. Guarantors are also seeking stronger step-in rights, allowing them to take over the space and power if they must fund obligations under the guarantee. Previously, such rights were often handled privately between the guarantor and the customer rather than expressly included in the lease.

- **Potential pitfalls in datacenter contracts:** the legal expert identified several potential "gotchas" in the contracts that, if not examined closely before signing, could cause serious issues later:

[1] For full disclosure, Jeffrey Moerdler is Bernstein's Global Software analyst Mark Moerdler's brother.

  - A buried termination-for-convenience right
  - Credit enhancement that is too limited or amortizes too quickly
  - A tenant's ability to transfer the lease while eliminating the relevant credit support (A transfer may be acceptable to a developer if the original credit enhancement remains in place, because the developer is relying primarily on that support to make the transaction bankable)
  - Excessive tenant control over expansion, contraction, adjacent development, and other future campus decisions
- **What's the downside to a neocloud contract?** Our expert expects several neoclouds (probably not the largest public ones) to fail in the next 1–3 years, due to a mismatch between its 15-year data center lease obligation and its customer contracts, which may last only days, weeks, months, or, in the strongest cases 1–3 years. However, with substantial upfront credit support, this could turn into an attractive immediately available contract at a lower cost either for the developer or the guarantor.
  - As an example, suppose it takes $10M/MW to build capacity and the contract has 30% upfront guarantee, if the neocloud later fails, the owner could regain a completed facility with an effective basis of $7M/MW (assuming possession can be recovered promptly) which can make the pricing very competitive in the market.
- **No demand slowdown:** the expert reports no current slowdown in deal activity. He sees more thoughtful underwriting and greater concern about becoming a counterparty to a speculator, but the overall market continues to move upward on a "hockey stick."
- **Future opportunities:** the expert expects demand for smaller facilities in urban, suburban, localized areas to grow over the next 3-5 years as the market moves beyond the training on remote campuses and develops more local inference nodes.

TRANSCRIPT

MM: Jeff, tell me what you do and what your expertise in the space is. Then we'll go into some questions.

JM: Hi, good morning. Thank you all. I'm Jeff Moerdler. I'm a real estate lawyer by background. I wandered completely by accident into the data center space in 1990, when a client of mine called me up and said, "We have a new deal for you. We're building a carrier hotel, and you're our real estate lawyer." I said, "Great, what's a carrier hotel?" "The precursor to data centers" they told me. After that, I got into antenna towers, cellular, building wiring, solar, wind, battery storage—anything telecom, technology, or energy overlaid on real estate. Up until 4 or 5 years ago, my practice was half general real estate and half data center and digital infrastructure. But with the explosion in data centers in the last 5 years, I'm spending 100% of my time, along with my team of about 10 lawyers, in the data center space.

MM: Excellent. Just for a sense, how many data center deals do you end up seeing in a year?

JM: Hundreds. There's a wide range. Usually, we represent the developer, owner, operator, or the party assembling powered land, but we're on all sides of the deals. We're doing 40 powered land assemblages right now. A ton of development deals. I just came to our Dallas office for a meeting yesterday with a client on a 3-gigawatt data center campus in Texas. We see a lot of deals. We're actively working, at any given time, probably on 30 or 40, probably couldn't juggle more than that at once.

MM: You see a lot of them. One of the questions we get all the time now is: how has the regulatory environment changed, or has it, and how is it impacting the ability to be able to execute and build data centers?

JM: There are a couple of pieces to that question. In general, the regulatory evolution is a very local thing. There hasn't been a ton of national-level change in the United States, but there has been a ton of local change, in part prompted by community opposition and lots of allegations, which I'm starting to believe, out there about foreign influencers impacting the community opposition. There are a bunch of organizations out there that have provided very one-sided manifestos to communities about why and how they should oppose data centers, but they don't give the other side of the story. And there's a lot of misinformation and a lot of lack of education or due diligence, and people just join the rah-rah moment and scream and yell in opposition. I say, half in jest, that I'd like to stand outside one of these community meetings with a garbage pail and insist that everyone walking

in who opposes data centers deposit their iPhone, Android phone, Apple Watch, Fitbit, connected hearing aids, laptop, iPad—everything—in the garbage pail, because they don't understand that things we all now rely on in our day-to-day life need a data center to operate. I saw a statistic recently that the average person is connected to between 50 and 75 data centers during the course of a day between their phone, their laptop, their desktop, and their other connected devices.

We're juggling all of that at the same time as we're dealing with a challenge related to power. The power industry in the United States existed for 100 years with between 0 and 1% growth in electric demand. Then it experienced 10 years of decline for its generation because of energy efficiency and bringing on renewable energy. And then, 4 years ago, it went up the hockey stick. And we're now seeing this exponential growth, which has its roots in a lot of events that have occurred over the last 10 years or so.

MM: Great answer. Following up on the energy side, two related questions: How impactful is it on the ability to both get these data centers built and even get these data centers papered from a contract perspective? And is that the area of focus you're seeing in terms of the main reasons why they shouldn't build data centers?

JM: It used to be that for data centers, like most real estate, the motto was "location, location, location." And before the last 4 years, if you wanted to put up a data center in any major market, you just called up the electric utility, told them how much power you wanted, and usually they could deliver it when you wanted. Maybe they'd need 6 months or a year to put in some new transformers or wiring or create the driveway from their nearest substation to your building, but they'd deliver, no questions asked.

That all changed with the exponential growth and the inability of the electric utilities to serve the exponential amount of demand. In Texas right now, I believe there are applications pending—or maybe there were before Batch Zero got rid of a bunch of them—for 4 times the power available in the entire grid in Texas. A ton of that is speculative. The utilities and the regulators—I liken what they're doing to college or med school or law school applications. You need some easy way of narrowing the funnel. In applications, it's SATs, LSATs, MCATs, GPAs, to reduce the number of applications to a manageable number. In electric power, they're doing it now through deposits and requirements for security to try and get rid of the very speculative deals where people are saying, "I have a nice piece of land. I'm gonna call it a data center and sell it for a hundred times the agricultural value, and so I'll put an application in for a gigawatt of power." And they have no customer, no expertise, no money, no nothing. And the utilities are trying to narrow that funnel and deal with that exponential growth in the applications.

It makes it more complicated, so it's now "power, power, power." That's a top issue. I think it's moved off a drop in the last year or so, where it was exclusively the top issue: availability and timeline, and ramp, and cost to bring power to a site. Now, the community opposition has ratcheted up. Are you in a community that you can work with? And the rules are changing every day, so developers of data centers are also concerned: am I in an area where I think everything works today, but the rules change a month from now? So there's a myriad of considerations.

Water is becoming a more important consideration, although most new data centers are low-water-usage. Again, misinformation out there in the community about data centers taking away all the water. There was a great statistic—I think it was on 60 Minutes—that golf courses in California use twice as much water as data centers.

MM: A lot there. Of the data center contracts you're seeing, do they include a requirement that the data center vendor assure this power? If they don't include it, does it end up being behind the meter? What's the approach?

JM: Back up a step. Five years ago, a 25-megawatt data center was a large data center, and a 1MW lease was a large lease. With the exponential growth in demand prompted by growth in the cloud and by AI, now 100 megawatts to multi-gigawatt is an average deal, and under 100 megawatts is a small deal.

It depends on how the deals are structured, and those larger deals are all bespoke. The structure of every deal is different, based on the local community, the customer, whether there's a credit enhancement to the lease, and what those parties' requirements are, and every space is built out on a larger one, to some degree bespoke, which creates problems for the industry and complexities. But certainly somebody is assuring that the power is available.

If you're doing a powered land assemblage, for example, the real exponential increase in value of the land occurs can show you have power or a definitive pathway to the power, which can be in a ramp-up, in installments. If you currently available or within 12 months, or the first tranche or 25% of the projected power in 12 months, you ha asset. If it's 12 to 24 months, it's solid gold. 24 to 48 is silver. More than 48: don't call me; I'll call you. Nobody's s occasionally, but generally not—looking that far out, particularly because the industry wants instant gratification.

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ramp up, so they want the immediately available power, which is why, if you've got a site, it doesn't have to have all the power.

If you're projecting a site with 400 megawatts, and you can show you have about 100 coming online in the first 12 or even 24 months, and you've got a pathway to the additional power that's pretty certain, you've got a great asset. And definitely the power is critical, but every deal is different as to who's chasing the power. We signed a contract to sell a 2+ gigawatt Texas Batch Zero data center campus for about $2 billion to a public company. And, we've processed the paperwork and confirmed that it was allocated in batch zero, but the buyer is going to process it from this point forward. We created the pathway; they'll take it from here. There are other deals where the buyer or the tenant wants to see the first tranche energized. I did a build-to-suit deal with a large financial services firm recently, where they signed a long-term lease, a build-to-suit lease, and it was our obligation to get the power. And the rent commencement date for the space was energization of the first tranche of power at the substation adjacent to our site. Each deal is bespoke.

MM: One more quick question, and then I'll hand off to Madison. What's the mix of what you're seeing in deals? Are they mostly hyperscalers? Are they neoclouds? Does it change constantly? Are they enterprise?

JM: It's all over the place.

MM: and changing?

JM: The acceleration in the market in the last few years has been hyperscalers, and I use a narrow definition of Hyperscaler: Microsoft, Meta, Google, Amazon, plus nowadays, Oracle. Those are the only hyperscalers in my book. Everybody else is a wannabe.

Those are the only ones that are really operating cloud, which I view as outsourced operation of a data center at a high level. Then it's the AI companies. And now, the last few years, the new business model of neoclouds, and even more recently, the chip manufacturers. And lots of data center developer/ owner/ operators. We're seeing all of them out there. I am seeing a shift in the last year or two in that, two years ago, 95% of what hyperscalers did was leasing data center space and power. They only occasionally developed it themselves, in part because they didn't have the staffing to deal with that, considering their exponential growth path, and they wanted somebody else to take the risk and provide the expertise. They would occasionally build a flagship kind of facility, a zero-water-use facility that they might build themselves.

But in the last year or two, I'd say hyperscalers are doing 20% of the builds themselves. They're acquiring the land and building it themselves, as they've built out their real estate departments and realized, long-term, it's more cost-effective, and they have a lot of cash in the bank and a lot of sources of debt and equity available to them. The AI companies are not building it themselves, nor are the neoclouds. But a lot of the developer-owner-operators are. All those companies are building themselves and either creating their own powered land assemblages or acquiring them.

MM: Perfect. Madison, you had a question.

MR: I want to go deep on some of the Neocloud contracts in a minute, because I think, especially given the news in the last couple of weeks, there's probably a lot of demand, but let's start broader for a second. Talk to us about how tight these leases are, particularly the Co-lo leases, and maybe the difference between the Hyperscalers and everyone else.

JM: As I said, every deal is bespoke, and different developers, owners, operators have different financial pressures on them, so they may be more desirous and more flexible in closing a lease deal, and they might be able to do it with a party with weaker credit because they need to show their bank or their investors that they signed a lease, even though it may not be as strong a lease. Or they may be more flexible on the lease terms, giving a termination for convenience. One of the things I've noticed: every single Hyperscale deal I've ever done—there's only one I've done in recent years of any size, a megawatt or larger, that was on the landlord's form.

The hyperscalers insist you use their forms. And every one of those forms contains, buried in it, in at least one or two places, termination for convenience. And every single time I put it on the major issues list after I see the form lease and have a conversation with the Hyperscaler, and say, "By the way, this termination for convenience—you're leasing 20 or 100 megawatts, and we're doing some custom build for you and spending millions of dollars. This termination for convenience is an accident, right? The lease would be unsaleable on the facility and unfinanceable. We negotiated pricing on a 10-year deal." And I am convinced that the Hyperscalers give acting lessons to some of their staff, because every single time somebody stands up and says with a completely straight face, "Really? That's a problem for you? Everybody else agrees to it." Neither anybody I'm advising nor any other sophisticated data center lawyer would allow a termination for convenience unless they missed it,

because they are buried in the lease documents.

MR: To be clear, they're always asking for it, and they're usually not getting it.

JM: They say they get it all the time. That I don't believe. I believe they get it occasionally because some people are either too unsophisticated, didn't read the document carefully, or are too desperate, and just say, "I've got a Hyperscaler. Where do I sign on the dotted line?" And they'll give them anything they want, which includes extraordinary optionality, expansion of space, expansion of power, both space and power, right of first refusal, option of purchase, extension options. Again, their form documents essentially give them control, and their theory is, "I'm giving you an investment-grade credit and a name that adds huge value to your asset for sale and financing purposes, so I should get anything I want."

MR: I often think about different buckets of developers. At the really credible end, we've got Digital Realty, Equinix; they tend to be conservative, smaller deals, not doing huge builds in West Texas. Then you have the middle ground, which is a lot of PE-held developers, some of whom have really strong track records. And then you go down the spectrum, and you get to some of miner converts, no-name—I sometimes call them "dudes with PowerPoints"—who just has a building, and all of a sudden, they're a data center developer now. Is it fair to think that that kind of developer credibility also shows up in the leases? So we would see maybe the ones towards that long tail are not sophisticated enough to get the convenience termination rights out of the leases.

JM: Yes. The more sophisticated you are, and the larger a player, or the more unique an asset you have, the more likely you can negotiate from strength. If you're negotiating opposite to a Hyperscaler, you're always starting behind the 8-ball, because they have huge market power, and they're very sophisticated. And their form documents do an amazing job of giving them complete optionality and rights and controlling costs for them and such.

MR: Got it. Have you ever seen a Hyperscaler terminate for convenience?

JM: There was a rash of terminations in Europe about a year or two ago. I'm not sure, because I never saw the documents; I read about it in the papers. Microsoft and Meta terminated several deals in Europe. I'm not sure if they were terminations for convenience, or developer delay, or what the basis was. Personally, my guess is that all of the hyperscalers, and I think the AI companies too, have lots of different departments, or teams, or lines of business, and those teams compete with each other. I had a deal opposite a Hyperscaler where we were negotiating in an enterprise multi-tenant data center with two different groups at the same Hyperscaler, and we said, "Hey guys, why do we have to negotiate two separate leases? Why don't you guys partner up? We'll negotiate one lease. You'll both sign it. We can sign it as two separate leases or as one." They refused to talk to each other. They wouldn't work together. I think that the terminations in Europe happened for two reasons. One, because whatever that specific team or division was working on, the companies moved away and changed their business plan so they no longer were doing whatever that team was doing and didn't need this space. I think part of it was also a reality check for the market on the power of the hyperscalers.

Those are the only ones I'm aware of. And I think in today's world, if you have power, and you have space, and you have permits and approvals and a pathway to making the data center happen, even if the Hyperscaler or the AI company or the neocloud terminates, you have a hugely marketable asset, especially if you've built it and the power is available, and the customer walks or goes under, there'll be a lineup of people for that immediately available facility. You may need to do some work to modify it, because all the hyperscalers and the AI companies have their own secret sauce, and they want space built out and power delivered in their own particular engineering design. And you may have to unwind or modify some of that, and that's always a push and pull in developing these deals. How much do you make it bespoke, and how complicated is it to make it work for somebody else if the original customer leaves?

MM: Maybe follow up on part of that, then I'll hand back to Madison. What are the normal, acceptable, contractual reasons, if any are normal, for why these things can be canceled? Is it simply they can't build the data center? Is it long delays? What are normally the things that are acceptable to put in a contract?

JM: Losing that pathway to the power. For example, in Texas, if you didn't get put into batch zero, or you got shifted from batch zero to studied load, which may or may not guarantee you power, or got shifted to Batch 1. Losing that certain pathway to power is gonna be a problem. Most likely the deal wouldn't even be signed until you had that confirmed pathway to power.

And then there are delay exit rights. For example, one deal we did has a neocloud as a tenant with a credit wrapper from an AI company. In that deal, we have a time period in which to complete and deliver the premises, and we have some milestones. And if we don't hit the milestones—we had leverage, because we have the asset and they really want it. Sometimes, if you don't hit a milestone, if you don't get a signed ESA, PPA, whatever that utility calls it, by some date, the tenant has a termination right. Or if

you don't build your foundations or the pad for the substation—there are all kinds of timeline milestones. We were able, because we had leverage, to bypass the termination right for any of those milestones. So as long as we complete it by the outside date, we get as long as we need to catch up, and the only time they can terminate is if we don't hit the outside date for completion. And we have some extension rights and force majeure rights built into that.

Again, unfortunately, there's no rule of thumb. Every deal is bespoke, but generally there will be milestones on a new development deal or even a build-out. You have an existing 50-megawatt multi-tenant data center, and you're building out 5 megawatts for a new customer in the building. If you don't deliver by a certain date, that customer is gonna have—almost certainly, if they negotiated well and had some power in the market—some liquidated damages. As a hypothetical example, if you're supposed to deliver the space by June 1st, and you don't hit June 1st, that date might get extended for up to 60 days for force majeure. But if the delay isn't force majeure, the tenant gets 1 day of extra free rent for every day of delay for, say, 60 days. Then, after 60 days, it ratchets up to 2 days for each day of delay. Then, at 120 days, the tenant has a termination option. Again, there are rules of thumb that vary based on the size of the deal and the nature of the customer and their market power.

And the market has shifted in the last year or two to give much more market power to the developer-owner-operator because of the scope of the demand in the market. But the Hyperscalers, because of their credit rating, and the chip manufacturers also have huge leverage in the market. And we've also seen the beginnings of the chip manufacturers starting to do deals themselves. I think they're pulling back and are concerned about neoclouds and startup AI companies. And instead of their giving a credit wrapper or some sort of credit enhancement to the neocloud or smaller AI company, they're saying, "I'll lease this space or own it. I'll control it, and I'll lease to you, the neocloud, so that I have more control over the deal. And if you're no longer buying your chips from me, or if you're not moving fast enough, or your business doesn't meet financial tests, I can get rid of you and replace you." Just starting to see that develop.

MR: I want to go there, but before we get there, can we just talk about the neocloud leases? My understanding is that the vast majority of them have to have a credit wrapper. Is that fair?

JM: If you're doing a new development, as opposed to an existing building that's already a data center and leasing the space. In new development, it is extremely rare to do one without a credit wrapper. Again, it gets back to how sophisticated the developer is, how liquid they are, if they have the cash, how willing they are to take risk. But every deal I'm doing involving a neocloud has some credit enhancement. It could be structured a lot of different ways.

MR: Please elaborate.

Jeffrey Moerdler: For one of the deals, we're getting a combination of a contribution to capital—cash—from the Neocloud to help build the space, because they've raised a bunch of money, and they have liquidity, even though they don't have income and a track record, in most cases. So we're getting a combination of upfront cash contribution and a credit enhancement from an AI company that's backing this neocloud.

Other deals are a letter of credit, a limited guarantee. The scope of the guarantees, or the credit wrappers, or credit enhancements has changed over the last 10 months. That's been a very dynamic space, prompted by one of the hyperscalers, which about a year ago changed the market by saying, "We're no longer giving a full guarantee. We're going to give a limited guarantee, and that limited guarantee is designed to help the developer get a construction loan." So they say, "We'll guarantee 80% of the construction loan, but we're not guaranteeing all the rental under the lease. You, the developer, have to put up your 40, 50, 60% equity above the construction loan. That's all at risk, and 20% of the construction loan is at risk." So they're giving the bare minimum to help get a construction loan in lieu of the old days where they gave a full guarantee. In addition, those guarantees typically amortize on a straight-line basis over the term of the initial lease. So if you have a 10-year lease to the Neocloud, by year 7, that guarantee is essentially worthless, because it's amortized down.

On the other hand, my belief is that if we're going to see problems in the neocloud or the AI startup spaces, we're going to see them in 1 to 3 years. And I am convinced we will see some bankruptcies. Not the largest AI companies, but more market-specific, smaller AI startups—somebody who's creating an AI specifically for law firms, or specifically for the garment industry—won't generate revenue and will crash and burn. And I think you'll have some of that with the neoclouds also, because the neoclouds worry me in that they are WeWork 2.0. There is a mismatch between signing a 15-year data center lease expense-side obligation and having a customer-facing agreement that could be by the day, the week, the month; in the best case, 1 to 3 years. I've heard about occasionally 5 years, but not more than that. So what happens when those turn over? WeWork burned for that reason.

MR: Preaching to the choir on that one, Jeff. We are long-standing neocloud bears here.

MM: By the way, your time horizon is not dissimilar from mine, but everyone thinks I'm nuts, but okay.

MR: Jeff, I think that's really interesting around the partial guarantee and the reset 10 months ago. My understanding would be that there actually were a ton of things signed in the market before that, even on construction that's maybe not done yet. Can you talk us through what the prior standard was? Also, it's interesting that that's from a hyperscaler. When we think about some of the chip manufacturers, are they also moving to partial guarantees?

JM: Everybody is… Almost every deal that I've done with a credit enhancement from either a Hyperscaler or an AI company or a chip manufacturer in the last 10 or 12 months—every single one of them has shifted, maybe not exactly to that formula, but yes, has shifted from the prior model of a full lease guarantee to that limited model. And the guarantors are seeking greater step-in rights: "If I have to pony up the cash under my guarantee, I want a right to take over the space and power and use it and reposition it," which is not an unreasonable position.

MR: What was it before?

JM: Generally, before that, sometimes they had specific step-in rights. More often, those rights were dealt with behind the curtain, internally between the guarantor and the customer.

MR: Got it. And in addition to the credit wrapper—and it would be useful to know the full versus the partial guarantee—are the rates on those leases correspondingly higher to offset the credit risk, or does an IG credit wrapper fully offset that for a developer?

JM: Again, very bespoke. Each developer sets their own standards. There isn't really transparency in the market, and each one has its own hot-button issues as to what the party giving the credit enhancement is willing to do and what the party receiving it is. So every deal is different. Unfortunately, there are no rules of thumb anywhere there.

MR: Yeah, no problem.

MM: That's good; you can't be replaced by AI, then.

JM: Exactly. I'll put it a different way, and I think it applies equally to my industry as to yours. If AI replaces paralegals and junior associates, or your junior analysts, how do we train the next generation of law firm partners and senior analysts if they don't have a chance to go up through the ranks?

MR: I don't know.

MM: That's the conversation. Go on, Madison.

MR: I don't know how to make money on that in public equities, Jeff, but fair question for later. I think the concept of thinking about who has the negotiating leverage in these leases is a really important one and totally makes sense to me in terms of credible developers and hyperscalers.

JM: I'll interrupt and tell you one story to emphasize that negotiating leverage. One of my longtime regular data center developer-owner-operator companies—I'd done 10 deals for them opposite hyperscalers. And we had one situation a couple of years ago where we had the only game in town that would satisfy the Hyperscaler's requirement: the amount of power in the right location, control of the asset, pathway to power, the building already under development, so we could meet that timeline. We knew we were the only game in town in the market, so we decided to have some fun, which I had suggested to the client, knowing that it would be a one-time situation. But we said to the Hyperscaler, "By the way, if you want this site, we're not gonna extort you on the rent. We're gonna charge you a top-of-the-market rent, but you're doing this lease on our form, not on your form." It's the one time I did a deal in the last 7, 8 years on my form lease, not on the Hyperscaler's form lease, for a megawatt or more. And it was a really fun situation, but never to be repeated again, because the likelihood of our having that negotiating leverage is slim. Sorry, I interrupted you.

MR: No, it's a good story and a useful point. And again, not for today, but I actually used to negotiate against the Hyperscalers in my prior life at Verizon, so I really feel your pain, and they're brutal. But thinking about a situation where you're dealing with a neocloud and maybe a long-tail developer, right? Where is the balance of power in that?

JM: Dependent on the credit wrapper. And I've done deals opposite both of them. I won't say which neocloud, but a client of ours came to me about a year ago and said, "We've got this data center powered land assemblage. We're gonna build it," which is unusual. Usually the people putting the assemblage together flip it to somebody else, but this client was gonna build it. They're a developer, and they said, "And we got this lease from a neocloud. Can you take a look at it? What do you think?" I read the lease over a weekend, and I put about 50 comment bubbles in the lease, and I went back to the client, and I said, "This is a great form lease if you're a neocloud. It's not if you're a developer. If you don't get them to agree to change 3 quarters of those 50 points, I'm telling you not to do this deal." They read the comments. They sent it to the Neocloud. The Neocloud read it and said, "Maybe we'll change 10 or 20% of them," and our client sucked it up and said, "I'm not doing this deal," because it was too problematic in terms of things like termination rights and control over future nearby developments on the campus, and expansion and contraction. Everything under the sun was a thousand percent in favor of the neocloud. And they didn't have the credit to justify that. I would have expected to get that from a Hyperscaler, but I didn't think it was reasonable to get that from a neocloud without a strong credit enhancement.

MR: If I look at the capacity coming online, let's say in the next 12 to 18 months, probably most of those contracts were signed over a year ago, and I hear you on the ecosystem evolving a ton. Where do you think the "gotchas" are in the leases where we've maybe gotten smarter in what we're signing today, but which could be problematic in terms of the construction coming online?

JM: I think, buried in some of those awesome time bombs, the one that worries me the most is the missed termination for convenience. Also, how the credit enhancement is structured, and is there a risk that either the neocloud or smaller AI company that's a tenant transfers a lease to someone else and the credit enhancement goes away? A lot of these are—

MR: Is that possible? Can they transfer these leases?

JM: Depends on how it was negotiated, but as a general rule, if you maintain the credit enhancement, then you can transfer it. Do we care, as a developer, if I have NeoCloud A, B, or C, as long as I have that credit enhancement from a Hyperscaler or chip manufacturer? Not so much, because I'm relying on the credit enhancement. That makes the deal bankable.

MR: Right. Got you. Mark, I have one more, but if you've got any burning, you can go ahead.

MM: Quick one for you.

MR: Sure.

MM: It sounds like, at this moment in time, a credit enhancement for any of your definition of hyperscalers, or any of the major semiconductor guys, if it's well-written and the rest, is golden in terms of the value on it. Has that changed in any way, shape, or form? We've seen a number of the Hyperscalers go free-cash-flow-negative, starting to build up debt. The concern has been how much they're building. Is that having any effect on taking their credit enhancement?

JM: One of those parties whose credit has been put into question more recently because of the amount of debt—it's becoming harder to do a deal with them. I have several deals in process. So far, they are all continuing, but my clients on those deals are all sitting there watching the Hyperscaler's credit rating and watching the market signals and thinking about what to do. But so far, I haven't seen it kill a deal that was under negotiation. A deal that hadn't been started, where parties are bidding on the deal —they're not taking that Hyperscaler's guarantee as seriously, and if they have another option, they'll go to someone else. But I haven't seen it kill a deal that was under negotiation yet.

MM: The point is, if the credit issues continue or get worse, then we could see that having an impact.

JM: Absolutely. It's most likely on new deals that haven't started negotiation, where there's a bidding contest going on, and you have offers from a couple of different neoclouds or Hyperscalers or AI companies with different credit enhancements, and you're comparing deals and haven't selected the one to start negotiating with. Absolutely, that becomes a bigger factor. There's a moral obligation and a sense of commitment once you sign a letter of intent, even though it usually doesn't create a legal obligation, and people are much more reluctant, which is why I say to my clients, "Even if it's a non-binding letter of intent, I want a letter of intent for two reasons." It creates that moral obligation on both parties, and people feel psychologically more committed to the deal. It's more tangible, and you have something to look back at and say, "Hey guys, this wasn't in the term sheet. Why are you asking for that now?" if somebody tries to add that termination for convenience. And I now put, for example, in all my letters of intent, "No termination for convenience." I want to hit that issue with the sledgehammer.

MR: Seems reasonable. Just a couple broader questions for you, Jeff. If you think back, just in terms of volumes, how many new deals are you seeing relative to 6 months ago, relative to 12 months ago?

JM: We're going up the hockey stick.

MR: Which is wild, considering we're still planning 3 years out on a good day, right? It may be even longer than that when we talk about the power secured. How early do you think you would actually see a slowdown in some of this contracting before we would see it in the actual construction numbers?

JM: I'm not sure I have that good a Ouija board to guess. How that will develop.

MR: But you're definitely not seeing it today, is the takeaway?

JM: No, I'm seeing a little more hesitancy, a little more thoughtfulness, but I haven't seen a slowdown in deals. I think the market is also becoming more sensitive to the speculators. And it's not just ERCOT with Batch Zero and other utilities that are trying to reduce the number of speculators in the market. I think people are becoming much more concerned about being a counterparty to a speculator.

Something you said jogged one other thought in my mind, a slightly different point. And that is, I see a missed opportunity out there in the market right now. As I said before, 5 years ago, a 25-megawatt data center was a big deal. Over the last 7 or 8 years, we've seen a ton of M&A in the data center world, with the public companies, the wannabe public companies, the formally public companies gobbling up mid-sized data center operators to move the needle, rather than developing one data center at a time. The result has been that the middle-market operator category has shrunk. And the place I see the impact of that: those companies that were gobbled up have been refocused on the 100-megawatt to gigawatt projects in general, and the market has not focused on smaller, urban, suburban, localized, enterprise multi-tenant data centers.

Full disclosure, I represent a lot of smaller data center owner-operators. I think that's a missed opportunity in the market. It used to be, 5 years ago, if you were looking for 250 kW to, say, 2 megawatts in any of the top 25 or 50 markets in the U.S., you had 5 to 10 providers competing for that local deal, particularly if it was for an enterprise, a bank, or a law firm or something. Now you're lucky if you have 2 or 3 in most markets, because half the providers got gobbled up and refocused on the big deal, and some of the remainders are out of power. So the pricing for that local data center capacity has gone up in most markets 50 to 100% in the last couple of years. And **Equinix, CoreSite**, and other smaller companies are doing very well as a result of that.

I think that demand is only gonna grow exponentially over the next 3 to 5 years as we have filled out the first tranche of the AI training on remote campuses, and we shift to more local inference nodes. And I'm seeing this. I just did a 2-megawatt lease in the New York City area, representing the operator of a multi-tenant facility for an AI inference facility in that city.

MR: I have just one last question. Jeff, I would like you to do your best Chicken Little impression on this one. It's clear that we've all decided we don't love Neoclods on this call, but let's play forward what actually happens in a downside scenario. Whether one of these goes under, or one of them, for whatever reason, needs to churn out of some of these data center facilities and doesn't grow—and you can debate the timing on that—but what tactically happens?

JM: My prediction is that it will definitely happen for several neoclouds—not all of them, probably not the larger public ones—in the next, I believe, 1 to 3 years. And what I'm counseling my clients is: focus heavily on that credit enhancement and how it's structured, because that may be your tenant in 1 to 3 years. And if you've got a good credit enhancement from a chip manufacturer, or a Hyperscaler, or even an AI company, then you're in pretty good shape.

On the other hand, it's a little old, the numbers have gone up, but it's easy math, and I'm not a math major. But if you use, as a rule of thumb, $10 million a megawatt to build data center capacity, I suggest to my clients that you get 30% up front, be it a letter of credit, cash security deposit, prepaid capital contribution, or a guarantee from an investment-grade party. So now you build the data center. It costs you $10 million a megawatt. And a year or two later, that neocloud craps out. Now you own a data center—assuming you're not in New York, where it takes a year to two years to get possession back, but assuming you can get possession in a few months—you now have a completed, fully built-out data center with a basis of $7 million a megawatt, which is immediately available as soon as you get possession. You have a very competitive asset there. You're almost better off in that scenario, because you can now remarket that, competing very cost-effectively against the guys with the 10-million-and-up basis per megawatt.

So the key to me is getting that credit enhancement and thinking through the risk of what happens if that neocloud fails. And I think the same applies to those smaller AI companies that are market-niche-oriented. So yes, I expect it'll happen, and I think the smart players who focused on this kind of a calculation will do fine. It'll make a lot of headline news: "AI is crashing," or whatever, in the Wall Street Journal and the New York Times. But the data center world will survive that too, and might even be better off in the long run, if you did a good deal.