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The Impact of SLA Exposure on Data Center Valuation and Financing

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Executive Summary

- Service-Level Agreement (SLA) driven performance exposure is a material financial risk in data center underwriting, directly affecting net operating income, debt service coverage, and asset valuation.
- Traditional insurance programs do not address SLA penalties or service credits, leaving a significant portion of data center cash flow volatility uninsured and embedded in transaction risk.
- As capital recycling accelerates, stabilized data center assets are increasingly used to unlock financing for new development making cash flow certainty critical to deal execution and pricing.
- SLA insurance converts performance-related volatility into a predictable, insurable outcome, enabling investors and lenders to underwrite data center income with greater confidence.
- By stabilizing the Net Operating Income (NOI) of colocation assets, SLA insurance expands the pool of institutional capital and enhances liquidity across the data center investment lifecycle.

Understanding SLA exposure is essential to data center financing

The data center industry is in the midst of a structural boom. It has evolved from a niche segment into a foundational pillar of global digital infrastructure, driven by increasing demand for cloud services and AI capacity. Morgan Stanley estimates that data centers will require an additional \$1.5 trillion of new investment-grade financing over the next five years to meet this demand.

For investors, the appeal of this asset class is its combination of real estate fundamentals (physical assets, location and power-grid dependency) with infrastructure-like stability (critical digital services and persistent demand). However, as capital requirements increase, the sector is becoming more reliant on institutional and long-term investors who prioritize predictable and stable cash flows.

At the same time, hyperscaler customers require strict Service Level Agreements (SLAs) with financial penalties tied to uptime performance. While these agreements reinforce operational discipline, they also create financial exposure for owners-operators.

Rising AI workloads, higher power density and operational constraints are increasing the likelihood of performance disruptions.

When SLA thresholds are breached, service credits and contractual penalties are triggered, effectively functioning as a variable operating expense that can erode Net Operating Income (NOI). This introduces cash flow volatility that can affect valuation, leverage and debt-service coverage - particularly as stabilized data center assets are increasingly used as collateral for new development financing.

Addressing this exposure is becoming important to maintain the investment profile required by institutional capital and lenders. One approach is SLA insurance, which transfers the financial exposure of performance breaches and helps stabilize cash flows.

This paper provides a practical framework for investors and capital providers to understand, assess, and manage SLA-driven exposure of data centers. It also demonstrates the return on investment of SLA insurance as a financial tool and why, at a time when cash flow certainty is central to financing and valuation, it has become a critical enabler of long-term growth in digital infrastructure.

SLA Exposure in Operations

Once a data center becomes operational, SLAs with tenants define required standards for uptime, power, communication and environmental conditions. Unlike traditional operating expenses, because SLA penalties are non-discretionary and contractually enforced, they can be triggered by brief performance deviations.

Operational disruptions as short as 26 seconds can result in penalties in the form of tenant credits, rent abatements or in extreme cases, lease termination.

While SLA structures vary by tenant and contract type, under standard hyperscaler and enterprise colocation contracts, penalties for outages are often calculated as a percentage of Monthly Base Rent (MBR).

Depending on outage severity and duration, agreements could include:

- Service credits ranging from approximately 100% to 200% of MBR
- Enhanced penalties for critical connectivity outages - potentially reaching several multiples of MBR or up to one year of rent
- In severe or repeated breach scenarios, the tenant has termination rights, which if exercised, could leave a data center empty without any revenue

These penalties function economically as a variable operating expense, directly impacting NOI and weakening the asset's credit profile and valuation.

Since stabilized assets are often pledged as collateral for new development loans, SLA-driven volatility amplifies financing risk. Moreover, a history of solid operating performance is a critical element to refinance data center assets successfully.

The Impact of SLA Insurance on Data Centers

SLA insurance converts volatile, unpredictable SLA exposure into a fixed and manageable cost helping to improve credit, stabilize cash flows and support valuation growth.

Some SLA policies mirror the agreement terms and pay out a pre-agreed amount when a breach occurs. This delivers immediate liquidity that offsets the financial impact of NOI volatility resulting from rent abatements, service credits, and contract termination.

By protecting against tenant churn and potential debt service disruptions, SLA insurance can provide a reliable backstop during moments of operational stress. This results in a fundamental shift in asset behavior.

From an investment perspective, SLA insurance could potentially:

- Reduce NOI volatility
- Improve cash-flow predictability
- Support credit rating improvement
- Enable capitalization-rate compression and increase asset valuation
- Enhance underwriting confidence for lenders and equity providers

This transforms operational volatility into predictable, bond-like cash flows, aligning data center assets more closely with the expectations of institutional and long-term capital.

Financial Impact of SLA Breaches (Use Case)

To illustrate the financial impact of such events, consider a data center that generates \$144 million in annual rent and \$57.6 million in annual cash flow.

In the case of a typical hyperscale SLA specifying 99.99% uptime, a 45-minute outage could trigger a 100% MBR service credit, resulting in a \$12 million penalty and reducing annual cash flow by 20.8%.

In a more punitive SLA, credits could reach 200% of MBR, totaling \$24 million in penalties and reducing annual cash flow by 41.7%. This can be shown in the table below with the following assumptions:

- **Annual Rent:** \$144 million
- **Potential SLA Penalty:** 100% – 200% of MBR
- **Annual Cash Flow:** \$57.6 million

	Without SLA Insurance	With SLA Insurance
100% MBR SLA credit	\$12 million loss	Insurance payout offsets penalty
200% MBR SLA credit	\$24 million loss	Insurance payout offsets penalty
Severe outage + secondary impacts (tenant friction, NOI volatility)	\$12 million - \$24 million loss	Insurance payout offsets penalty and stabilizes NOI

With SLA insurance in place, the financial impact of such penalties can be significantly mitigated. Payouts are aligned with the outage severity, duration, and contractual credit structures, providing timely liquidity when needed.

Because data center valuations are fundamentally driven by income, this example also illustrates the strategic role of SLA insurance in protecting asset value. By stabilizing NOI in the face of performance disruptions, it directly supports stronger pricing, improved financing outcomes, and greater confidence among investors and lenders.

How Investors and Lenders Can Assess SLA Exposure

For lenders and investors, SLA exposure should be evaluated with the same rigor as power availability, tenant creditworthiness, and lease term. The following framework can be used to assess exposure:

Step 1: Understand the SLA Structure

Begin by evaluating the contractual performance obligations embedded in tenant agreements.

- Identify uptime requirements, thresholds, and response standards
- Quantify maximum possible service credits
- Review tenant termination rights and triggers

Step 2: Evaluate Operational Performance and Design Risks

Assess the likelihood and severity of SLA breaches based on operational resilience.

- Review historical outage data and root cause analysis
- Assess power, cooling, and network redundancy
- Evaluate operational maintenance and business continuity procedures
- Review staffing and key personnel depth

Step 3: Model Financial Exposure

Translate operational exposure into financial impact.

- Stress-test NOI under SLA breach scenarios
- Assess loss implications under downside cases

Step 4: Evaluate Cash Flow Securitization

Assess the likelihood and severity of SLA breaches based on operational resilience.

- Compare insurance coverage limits to modeled downside risk
- Confirm alignment between policy triggers and SLA mechanics
- Assess whether coverage delivers timely liquidity to protect NOI and debt service

Enabling Investment and Financing Outcomes with SLA Insurance

As data centers become core infrastructure supporting the global digital economy, the ability to deliver stable and predictable income is becoming as important as the physical performance of the facilities themselves. For investors and lenders, understanding and addressing SLA-driven performance exposure is essential to assessing income durability and downside risk.

SLA insurance provides a practical financial solution to manage this exposure by transferring the financial impact of SLA penalties to the insurance market. By converting unpredictable performance liabilities into a defined and manageable cost, it helps stabilize income streams and reduce uncertainty in underwriting models.

This stability can translate into stronger financing outcomes. More predictable cash flows can support improved debt service coverage assumptions, enhance lender confidence, and broaden the range of institutional investors willing to allocate capital to the sector.

The scale of capital required to support AI infrastructure will continue to grow and the market will increasingly differentiate between assets that can demonstrate resilient, financeable cash flows and those that cannot. Investors, lenders, and owner-operators that proactively assess and manage SLA exposure will be better positioned to access institutional capital and execute transactions in a more disciplined financing environment.

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