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Building Data Centers in New or Secondary Markets: Challenges and Strategies

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As the demand for cloud computing, digital services, data storage and artificial intelligence capabilities continues to skyrocket, the data center industry is rapidly expanding beyond traditional hubs in places such as Northern Virginia and Silicon Valley. To satisfy the increasing demand, data center developers are increasingly looking to new or secondary markets as attractive alternatives. These new and secondary markets can include small towns and rural areas that have not historically been the beneficiary of major data center projects. While these emerging locations may offer opportunities in terms of cost and land availability, they also come with unique challenges that require strategic planning and execution.

The Allure of New and Secondary Markets

Secondary data center markets are gaining momentum for several key reasons:

Lower Costs: In new and secondary markets, land is often both more affordable and plentiful, making these markets financially attractive for both hyperscalers and collocated data center operators. In addition, some of these markets are able to provide utility services at affordable costs with a reduced level of competing demand from other customers. For those markets that have sufficient power and water services to support new data center development, they are well positioned to compete for new projects.

Incentives: Many states and local jurisdictions offer competitive tax incentives and development grants to attract data center investment. For communities that have not historically benefited from data center development, there is often a greater interest in attracting new investment in technology through economic development incentives.

A number of states offer sales and use tax abatements that are particularly attractive to data centers given the high costs associated with refreshing equipment. In addition, local jurisdictions in many cases offer real property tax abatements (and where applicable personal property tax abatements) that permit new and secondary markets to become attractive alternatives for data center development. In some cases, development grants may also be available to support project infrastructure, including new road construction.

Proximity to End Users: Many of these new and secondary markets are in locations which are not proximate to other data center developments. With digital consumption spreading across geographies, locating closer to population centers helps reduce latency and improve performance.

Diversification and Risk Mitigation: With increasing frequency, data center developers are seeking to add geographic diversity to reduce risk from overconcentrating in established hubs. New and secondary markets can position data center developers to avoid a variety of risks including (i) constraints on the available power or water resources, and (ii) political risks associated with the tax and regulatory environment. This latter risk is highlighted by the number of jurisdictions which have recently made news by limiting, or attempting to limit, the availability of economic development incentives for data centers.

Challenges in New and Secondary Markets

For data centers, developing in new and secondary markets is far from straightforward. Despite having a number of advantages, these markets will often come with added hurdles.

1. Lack of Proven Track Record

Unlike established data center hubs, which have a proven track record of success in delivering support for data center projects, new and secondary markets may carry additional risks for data center developers. Local governments in newer markets are more likely to overestimate their ability to deliver services and build infrastructure. They may also miscalculate how timely such services and infrastructure can be constructed. This mismatch often comes from inexperience. It is easier for developers to have confidence in local jurisdictions that have already successfully supported other large scale data center projects. In contrast, a project in a new or secondary market is more likely to encounter unanticipated difficulties.

2. Infrastructure Delivery Constraints

Many secondary markets lack the type of robust power and water infrastructure more commonly found in mature data center regions. Limited grid capacity, lack of redundancy, and extended lead times for utility upgrades can delay projects. In some cases, new and secondary markets are more likely to require water treatment plant upgrades to support large scale data center projects. In addition, even in jurisdictions with available water capacity, projects sited in more remote locations can face additional challenges in having services delivered to the project site.

3. Limits on the Availability of Skilled Labor

Data centers require highly trained technicians, engineers, and construction professionals. In newer markets, the talent pool may be limited, leading to higher recruitment costs or the need to import labor from other regions.

4. Regulatory Obstacles

Local jurisdictions that are unfamiliar with the scale and requirements of data center projects may present unexpected zoning, permitting, or environmental challenges. Navigating local bureaucracy can slow development and increase costs.

5. Political Opposition

Data center projects in new and secondary markets may have a greater tendency to encounter political opposition. It is not uncommon for local residents to express concerns about changing land use, increased water and energy consumption, and other impacts on the local community. In established markets, these concerns are more easily balanced by actual experience, including the economic development benefits associated with data center projects.

Strategies for Success

There are several key steps that will better enable a data center developer to find success in newer markets. First and foremost, the developer should engage early with local government officials and utility providers. A developer in newer markets will not have the benefit of simply asking for the same deal that the last project received. Instead, the developer will need to proactively engage with local officials to address incentives, zoning and other development needs. Similarly, a developer will need to work with utility providers to secure power and water commitments and better understand infrastructure timelines.

For projects in newer markets, it may take longer to negotiate incentive agreements. In many cases, local officials in those markets may not have experience with the preferred types of incentives. Counsel can play a critical role in enabling the parties to work through the requirements of complex economic development incentives.

In some cases, it may also be desirable to negotiate a development agreement with the local jurisdiction – particularly in newer markets. Development agreements can offer a number of benefits including (1) protecting development rights, (2) streamlining permits and approvals, and (3) securing infrastructure improvements. These agreements can be particularly helpful in newer markets by ensuring that the project has a good path for development in a jurisdiction that may not have an established track record.

Every developer also needs a good sales pitch. This is particularly true for newer markets where local officials are less likely to be familiar with the impact of a data center project. That pitch should tell a story that explains the benefits of the project. Typically, those benefits include: (1) substantial capital investment in the local community, (2) permanent high paying jobs, (3) numerous temporary construction jobs, and (4) increased local tax revenues. Depending on the specifics of the project, this list of benefits could be expanded to include other items such as community involvement, a reliance on renewable energy sources, an emphasis on hiring local workforce and the development of public infrastructure improvements. In

each case, the developer should listen to the concerns of local officials and wherever possible try to incorporate ways to address those concerns.

Looking Ahead

New and secondary markets represent the next frontier for data center expansion. If data center developers can balance the promise of cost savings and growth against the potential operational and infrastructural challenges, they can unlock substantial value. Success in these regions requires not just financial investment, but a careful strategy and planning. Data center developers who are able to navigate through the myriad of challenges will be able to find success in many of these less-charted territories.