

Be resourceful when outsourcing

Data centres comprise a growing property sector – one with unique issues that tenants must not ignore. By *James Dodsworth* and *Simon Hartley*

With IT budgets under pressure, the benefits of outsourcing to specialists and taking a lease are compelling. However, involving a third party as a landlord in a lease arrangement rather than using an owner-occupation model can be a hard concept to sell to management given the perceived loss of control in becoming a tenant. A properly negotiated and balanced lease is crucial in making outsourcing acceptable.

Different perspectives

Documentation relating to data centres can differ substantially from occupational leases that have developed in the industrial and office markets. This is particularly apparent for larger data centres, where the twin drivers of capital expenditure and business-critical infrastructure are accentuated. Tenants that approach this sector without considering the specialist requirements and differences may find that the landlord and tenant relationship does not meet their expectations and that their legal and practical solutions and remedies are adversely affected.

Where tenants require larger facilities for periods exceeding five years, they increasingly prefer to dispense with a service agreement (and its related “lift and shift” provisions) and to adopt the exclusive occupation offered by a lease. The certainty relating to occupation usually outweighs the disadvantage of having to pay stamp duty land tax (SDLT) against the rent under a lease (none is due under the agreement).

The relatively high rents under leases of larger data centres means that landlords will require strong tenant financial covenants, either directly or via a parent guarantee. Tenants should ensure that the alienation provisions do not unreasonably bind them into a minimum covenant test on assignment or underletting. An ability to share the use of a facility without consent may also be vital to the tenant’s business plans; traditional alienation provisions may not accommodate this type of licensing arrangement.

Different owner/operators will approach the cost of providing power in different ways. Some will charge an inclusive rent while others will flow through the costs, either on a pass-through basis or with a percentage uplift. The tenant should make sure that the necessary level of power is freely available without penalty and that the

basis of charging is transparent. The lease could include worked examples to clarify what is included and, importantly, what is excluded. These costs can be significant and tenants should ensure that they are itemised separately from the definition of “rent” and any other landlord services, so that the level of SDLT is not unnecessarily increased.

It is also important to consider how the carbon reduction commitment is addressed. Organisations with annual electricity costs of more than £500,000 will have to purchase carbon allowances equivalent to their energy use. It will be necessary to determine which “organisation” is required to surrender the allowances, who pays for them (and decides when to buy) and who receives the benefit of any credits. Standard service charge provisions may be

In *St Martin’s Property Investments Ltd v Cable & Wireless UK plc* [2007] EWHC 582 (Ch), the review clause included an assumption that the “demised premises comprise high-class professional or commercial offices”. Following a change of use, the clause was amended to provide that the new rent would be 90% of the open market rent for high-class offices or, if greater, for a computer centre. The court decided that the parties had intended the rent to be reviewed on the assumption of office use since, with a lack of comparables, it was difficult to ascertain the open market for the computer centre. Basing the review on the actual premises would have sparked a debate as to what alterations would be required to meet the assumption of offices, which had not been altered by the drafting

amendments. Greater care in varying the lease would have aided the parties, but the general lack of comparable evidence remains an issue on open market reviews.

Operational objectives

The appropriate provision of services such as power, cooling, heating and humidity control are vital to the controlled environment that allows premises to function as a data centre. Careful drafting of the provision and levels of service are vital. Equally important are the remedies available for a service level breach and the trigger for such a breach. Rental credits, self-

help remedies and, ultimately, termination rights are common in data centre leases.

The quality of the facility and equipment, combined with the level of rent, will in part dictate what combination of service levels and remedies can be negotiated. A landlord will want its liability to be capped, given the substantial sums that can be lost on service failures, especially for applications such as trading platforms. The tenant will also want to manage its position carefully. If it exceeds power usage beyond predetermined levels, the service may be interrupted or large financial penalties imposed.

Such provisions can damage the tenant’s business. They also highlight the need for the tenant’s IT specialists to be involved in lease negotiations to ensure that the lease is consistent with operational objectives.

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inadequate to deal with the data centre’s energy consumption and the effect of environmental legislation.

Provisions relating to alterations may be less restrictive than those typically found in multilet office buildings. Alterations that are customary in the sector, such as the installation of cabling and racking, should not be subject to landlord’s consent so long as they do not affect the building’s structure and integrity. At the end of the term, the costs of removing such items may be substantial. Landlords will want to receive back a facility from which they can generate income and that they can relet as quickly as possible. Both parties may find traditional yielding-up undesirable and early commercial negotiation is important.

Many data centre rent reviews are fixed by way of a stated annual percentage uplift. However, problems can arise on lease renewal or where the lease includes traditional open market review provisions.