



## **Considerations for landlords and tenants in leasing data center space - by Nina Rokat and Jessica Stanton**

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While the demand for data center space has been steadily increasing over the last decade or so, the pandemic has certainly caused a further increased demand in the market for these types of colocation spaces. Our clients continue to weigh the benefits of having data center space in-house and within their control versus the time and costs savings of outsourcing these types of services, and this analysis is further impacted by the increased server needs we are seeing as a result of the pandemic. Although many different industries are users of these data center spaces, the two biggest

industries that often partake in leasing data center spaces are the life science and financial services industries. Given that those who are involved in the life science industries often have immense research data, these data center spaces offer them additional storage and reliable maintenance of such data. Further, for hospitals, the need to comply with the vast array of regulatory requirements such as HIPAA and the need to maintain large confidential medical files incentivize them to consider leasing data center spaces as these centers offer them a robust, secure, and reliable mechanism for data storage.

Although there are significant benefits that a data center space can provide to a user, these benefits often depend on a tenant's ability to lease the right space. Similarly, in order to properly serve, and be competitive in, the data center market, those who own these data center spaces need to attract the right tenants. Below we offer some points for both sides to take into consideration when working on deals for data center/colocation spaces, keeping in mind as well that, analogous to how tenants make choices in other real estate sectors, the decision of which data center space to lease often comes down to economics, location, and the terms in the parties' Service Level Agreement (SLA).

### Considerations from Tenant Perspective – What a Tenant Needs to Consider to Make the Lease Advantageous

In finding the right data center space, from a business perspective, the tenant should consider the potential costs, savings, and reliability of the data center's support system in comparison to hosting the data in-house. The amount of leverage a tenant has in negotiating with the landlord depends, of course, on various factors such as the size of the deal and the state of the market. However, regardless of the amount of leverage available to a tenant, a tenant should keep the below factors in mind when leasing a data center space.

First, the types of remedies available to the tenant under the SLA are crucial. Given that the data center will hold and service "mission critical" servers, computer systems, and equipment with a large amount of tenant's data and given that reliable storage and maintenance of such IT infrastructure and data are essential to the tenant's business operations, tenants should push back on any limitation to remedies in the SLA. Landlords will often try to limit a rent abatement provided under the SLA with an overall cap on the abatement available. If unsuccessful in rejecting such a cap, it is important to at least have the right to terminate the lease if there is a chronic or catastrophic failure in the services to be provided under the SLA.

Second, a savvy tenant should seek a contractual rent abatement in the body of the lease to cover those obligations of a landlord that are not covered by the remedies typically provided in the SLA. Although the remedies in the SLA will purport to cover all of the remedies that a tenant will need in the event of a service interruption, there are generally additional services and landlord obligations covered in the body of the lease, which are not covered by the SLA. Like in traditional real estate leases, it is always advisable to push for landlords to provide for a contractual rent abatement in the event that a service is interrupted, a repair is not made or access is not provided and the same affects the tenant's use of the space. As a note, the time period for such interruption should be shorter in the data center context as opposed to what would be a market time frame in the

office/retail space context. Depending on a tenant's leverage, it may also be prudent to seek self-help rights given the nature of a data center lease where time is key in resolving any issues in the space.

Third, similar to the importance of having the necessary protections for the failure to provide essential services, it is also important to ensure that the landlord stands behind any work performed in the leased space on the tenant's behalf. If the landlord does perform work to prepare the space for the tenant's use, the tenant should seek to include a warranty from landlord for at least 1 year on any defects in such turnkey work performed by the landlord.

Fourth, since operations of data center space can be particularly unpredictable, and needs can increase and decrease over the (typically long) term of the lease, it is important to ensure that there is flexibility in the lease so that the space can fluctuate with the tenant's needs. Tenants should be sure to discuss this with the landlord upfront and know if expansion space will be contiguous and how the reduction or expansion of the space will affect the location of cage walls. It is important to attach exhibits which clearly show how the space can be changed if options are exercised.

Finally, the tenant should avoid agreeing to any restoration obligation at the end of the tenant's term. If the landlords are being adamant about the tenant's restoration obligation, the tenant may consider compromising but should limit such obligation to the fullest extent possible. This is one particular provision where obligations and expectations under a data center lease are different than under other commercial real estate leases.

#### Considerations from Landlord Perspective – What a Landlord Needs to Provide to Attract Tenants

In ensuring that a landlord's data center space is attractive to the tenants, the landlord should consider the needs and motivations of the tenants. Being able to adopt the tenant's perspective and understand the tenant's concerns will prove to be beneficial to the landlord as the landlord can address these concerns early on during negotiation and even expedite those negotiations. Similar to the tenants, the landlord should keep the below factors in mind during negotiation.

First, the landlords should keep in mind that the biggest concern of, and the main draw for, a tenant will be continuous operations of their data center. To assuage this concern, consider including representations or certifications as to the services provided, such as representing that there will be a certain number of days' worth of on-site fuel storage to provide back-up support in the event of an emergency event. In the event that there is an emergency or a disruption in the data center's operation, the landlord should provide for quick and timely restoration of the space. Depending on the significance of the tenant's space to the overall project, a landlord should also consider including certain self-help rights at the outset, with the appropriate notice and opportunity for the landlord to cure before the self-help right would kick in.

Second, the landlord should be quick and efficient, to the extent feasible, in preparing the space for the tenant as many tenants will be looking to sign a lease and get their servers and equipment up and running quickly. Given the current climate of supply and demand issues, if a tenant pushes for

late delivery penalties, it is reasonable for a landlord to provide same but with a realistic cushion and having it be subject to force majeure delays. Although at some point it is fair for the risk to shift to a landlord if the force majeure delays continue for an extended period of time.

Third, similar to traditional lease agreements but with a particular focus on the special data center services to be provided, the landlord should be clear in setting out in the lease the services that they provide (e.g., with respect to hot spot and other environmental monitoring), and how any disputes between the parties will be resolved (even if just resolved through good faith, reasonable cooperation of the parties).

Finally, the landlord should expect to offer and/or to be reasonably cooperative in certain accommodations a tenant is likely to need, such as the ability to have affiliates and business partners share space on the server and providing for tenant to be allowed to finance equipment, with landlord to provide for lien waivers to be delivered at tenant's cost.

## Conclusion

There are various factors that both tenants and landlords should consider when entering into a lease for data center space. As the market for data center spaces continues to grow, we expect that these considerations and related issues will continue to evolve. If you would like to discuss further or have any questions regarding leases for data center spaces, please contact the Olshan attorneys for guidance.

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