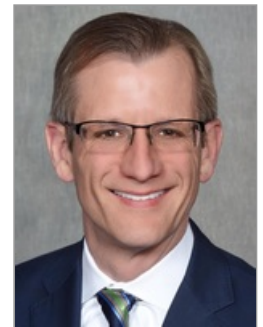


Why A Data Center Sale And Partial Leaseback Is A Win-Win

By **Michael Rehtin Jr.** (March 15, 2019, 3:44 PM EDT)

A new and burgeoning area of the data center real estate industry is the sale and partial leaseback of older data centers that were originally built by companies 10-20 years ago for their own use.

The companies selling these data centers range from banks and health care companies to retailers. When built, many of these companies anticipated steady growth and expansion in their data centers but with the storage capacity and processing power of computer servers skyrocketing over time, often the companies never fully utilized their data centers and in fact shrank inside of them to only occupy a smaller portion compared to when they first moved in.



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These data centers were expensive to build and not terribly efficient to operate because the mechanical cooling systems were being run for the entire facility despite the company only using a part of it. This led to large electricity bills because the company was both powering the servers and cooling their inefficient environment. Power usage effectiveness factors of 2.0 or more (for every 1 watt of power used by a server, another 1 watt was needed to cool the server) were commonplace while data centers built and run by specialized data center operators achieved PUE factors of 1.5 or less.

Since these legacy data centers were built, things have changed quite a bit:

- Some of the software applications that ran on the company's servers have now either migrated to the "cloud" or may now be appropriate for cloud migration, thus lessening the need for data center space.
- Companies now employ a "hybrid" solution in processing and storing data consisting of a mix of data centers owned by the company, leased or licensed data center space from a third-party data center provider and use of the "public" and "private" cloud.
- Current data center providers are experts at owning and operating data centers as an outsourced arm of the company's IT department.

These reasons have aligned so that companies with legacy data centers they are not fully utilizing can sell the data center to a data center operator who then leases back to the company an appropriate-sized portion of the data center for a rental lease payment rather than the company continuing to carry all costs associated with the facility. The purchase price for the data center is most likely less than the book value of the data center to the company but if the company is willing to recognize the loss and receive a payment for the data center, it will end up with a lower rent payment than continuing to cover all the costs of the data center.

Data center operators like this structure because they have an instant anchor tenant and can create immediate supply in a market. The time frame for developing a new data center and finding an anchor tenant can be lengthy and the sale leaseback eliminates much of this delay. "Hyperscale" users of data centers (major technology companies) often need space immediately and do not have the patience to wait out this delay.

This puts the data center operator owning the existing data center in a better position to land these large and coveted hyperscale deals in certain markets. The rent from the company may be enough to cover the debt and expenses of owning and operating the data center, so rent from new tenants is pure profit to the data center operator. The data center will likely have a proven track record of operating without outages and having been maintained by the company at the highest level so it will be "battle tested" and attractive to other tenants.

The company, however, it will relinquish some level of control in this transaction. The data center operator will install and implement new physical security and protocols to access the data center that the company will now need to comply with and the data center operator will also be allowing its employees, vendors, contractors and other tenants into the data center which potentially exposes the company's space and hardware to security risks. In addition, the company will no longer control the critical infrastructure systems that keep the power on at all times and the temperature and humidity in check.

Those duties will be taken over by the data center operator. The data center operator will grant the company a service level agreement that will provide the company some limited remedies in the event of a power or environment control outage but will not cover the company for anywhere near all the damages it could suffer due to an outage. Whereas the company had free reign to correct problems and maintain as and when it saw fit, now its rights are much more limited and their ability to exercise step in rights to cure a default by the data center operator will be limited if not nonexistent.

By outsourcing these duties, the company's IT department no longer needs certain employees who were running the data center for the company. Obviously this can cause angst in the IT department. As a part of the sale, the company could insist on the data center operator taking on some of these employees for a period of time. By doing so, the company will also have more confidence that the data center will continue to run to its liking because the individuals actually running operations have not radically changed.

After the sale, the data center operator will control the critical infrastructure (power distribution units, generators, cooling units, etc.) and will be obligated to operate and maintain them in accordance with the lease. Until other tenants are found for the facility, the data center operator may choose to not segregate the critical infrastructure that will be dedicated solely to the company from that which will service the rest of the facility. In this case, the company may continue to be responsible for the cost to run the entire data center until other tenants are found, but at a certain point the company's responsibility should be reduced as the data center operator needs to bear responsibility for leasing up the rest of the facility by adjusting the company's participation in costs to be proportional based on the company's use of the facility.

The data center operator may also not build, enhance or update the systems that will eventually benefit all of the tenants in the building until another tenant leases space in the building. Again, at some point the company should insist on these upgrades being performed regardless of whether the data center operator has found additional tenants or not so that the company's space benefits from the promised technological upgrades and redundancies.

The sale and partial leaseback of a data center is a clever way to right-size a company in its legacy data center, bring the most current technology to the data center and create data center capacity quickly in a market. As the need for data center capacity continues to mushroom and outstrips supply in certain markets, the data center real estate industry will undoubtedly see the sale and partial leaseback structure employed more often in the near future.

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