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Insights

CLOUD, DATA CENTRE SALE-LEASEBACKS AND THE PANDEMIC – ACCELERATING TRENDS FOR UK AND EUROPEAN REGULATED FIRMS

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SUMMARY

The COVID-19 pandemic has accelerated the two linked trends of financial institutions transferring their IT infrastructure to the cloud and selling their self-owned data centres in order to lease back only the reduced space and power they require. These transactions can be complex and there are key recurring legal features.

Many business trends within banks, investment managers, insurers and other regulated firms have been accelerated by the COVID-19 pandemic, few more obvious than the need for flexible IT infrastructure which accommodates the needs of a remote workforce. This has increased the demand for cloud delivered infrastructure-as-a-service, platform-as-a-service and software-as-a-service. In turn, this can reduce the demand on firms' self-owned data centres and create the opportunity to divest those assets at a time when there is high demand from funds and other investors for pre-built data centre space.

The move towards cloud was already a very strong trend in financial services, pre-pandemic. Most regulated firms have been making significant moves towards use of cloud services over the past five years, with both European and UK regulators adapting and updating their outsourcing guidance in recognition of the fact that not only is cloud viable for a range of applications relevant to a regulated firm, but it has a number of advantages. From the regulatory perspective, this includes in particular operational resilience. In March 2021 the PRA published its Supervisory Statement on Outsourcing and Third Party Risk, and called out as a key benefit of cloud the advantages of firms distributing their data and applications across multiple geographically dispersed regions. The PRA anticipates this will enable firms to respond and recover from local operational outages faster and more effectively, and to enhance their ability to cope with fluctuations in demand. In Europe, the European Banking Authority consolidated its separate cloud outsourcing and more general outsourcing guidelines into a single set of rules in February 2019, recognising the ubiquity of cloud

services in the banking sector. In February 2020 the European Insurance and Occupational Pensions Authority also issued its own updated guidelines, on outsourcing to cloud service providers.

Divestment of data centres by regulated firms has also been a trend over the past five years. Many financial institutions have identified that they have excess space and power capacity in their self-owned data centres, sometimes having completely unoccupied data halls sitting unused. By selling their data centre and leasing back only the space and access to power they need to meet their current needs, firms can release capital, remove the need to maintain the complex infrastructure associated with data centres and benefit from increased efficiencies that make their operations more sustainable. Purchasing a partial leaseback property can also be very attractive to infrastructure investors and co-location operators, as they get a proven site with a substantial anchor tenant and the ability to sell the un-utilised space and power. As the pandemic underlines both the challenges of operating data centres and the advantages of cloud based infrastructure, this is a trend we expect to accelerate.

BCLP has acted on a number of sale and leaseback data centre transactions for financial institutions and purchasers, both before and during the pandemic. Certain features recur and are worth bearing in mind when entering into this type of transaction:

- **Control** – the lease, with either integrated commercial technology terms and service levels or sitting alongside a services agreement, will provide a high level of assurance that the facility will be maintained to the required standard. However, by selling and leasing-back part of a data centre, sellers are relinquishing a level of control over the facility and will need to be comfortable that the benefits outweigh the reduced autonomy.

- **Identifying key drivers** – having a clear understanding of the commercial drivers is key to realising the desired benefits. For example, if flexibility is a key part of the rationale, the seller may want the ability to exit on relatively short notice. If the aim is to realise maximum capital from the sale, the seller may be willing to commit to a long-term lease in order to secure the best price. Being up front with buyers about key requirements will help to ensure a smooth sale process and help to avoid protracted negotiations.

- **Policies and processes** – by selling and leasing-back part of a data centre, financial institutions are moving a critical facility from being in-house, to being subject to an arms-length commercial arrangement. This will often mean that the relevant procurement team is closely involved and that the financial institution's policies and procedures for third-party contracts will rightly apply. Especially for non-European and non-UK purchasers the extent of these requirements can be a surprise, so it is helpful to identify the ask, and the rationale, early in the process.

BCLP's Data Centre and Digital Infrastructure team combines depth of experience and knowledge across a broad range of practice areas in order to provide extensive capabilities in all aspects of the

data centre ecosystem. This includes advising on acquisitions, disposals, lease-backs, financing, power purchase, user agreements, service level agreements and maintenance agreements. Our Technology team also regularly advises financial services institutions on their outsourcings to the cloud, including in relation to compliance with the regulatory regime. If you have any questions or would like to discuss, please do get in touch.

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