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RENEWING COLOCATION CONTRACTS: GETTING MORE AND SPENDING LESS

By Kirk Killian

Many data center managers are tasked with renewing colocation contracts that are expiring soon, which can be challenging.

Successful colo renewal goals include reducing costs, improving services, tightening SLAs, and creating contract flexibility. However, most data center managers are not experienced in handling this type of contract negotiation.

Conventional thinking is that colo customers are at a distinct disadvantage during renewal negotiations. Colo installations are considered "sticky," or difficult to relocate, since it can take over a year to methodically plan and move a data center. The renewal process is very occasional - perhaps once every five years for data center managers - but a frequent task for colo providers, creating a perceived experience and negotiation leverage imbalance working against the data center manager.

However, in reality, enterprises can successfully reduce costs and improve services during most contract renewals if managers are aware of market dynamics and intelligently plan the process. Managers can also materially improve the collaborative working relationship with colo providers during a contract renewal. This article discusses colo renewal strategies, improving contract terms, and getting internal credit for a job well done.

Understand the Market

To successfully negotiate, it helps to understand the background of market fundamentals.

Almost 300 mW of new high-reliability colocation capacity was under construction in the US in early 2020, improving the supply-demand dynamic for users.

Many existing colo facilities have available space for re-lease, due to enterprise over-commitments in their initial contracts years ago, coupled with move-outs of customers relocating workloads to public cloud. Increasing cooling densities have also created space availabilities, as users now place more hardware in less space, freeing up vacant space for new occupancy.

In most US and international locations, colocation pricing has decreased in the last two years. Many new colocation facilities are being built much larger than they were 5-10 years ago, and those scale efficiencies are being passed through to customers in both lower rents (as a function of lower construction costs) and lower operating expenses (since providers can manage larger facilities more efficiently than smaller ones).

Finally, improved migration tools (software, services, and circuits) have lessened some risks and costs of relocating to public cloud or other colo facilities, adding credibility to relocation options. However, most colocation users still prefer to avoid the costs and risks of moving an entire data center.

Planning the Process

The process for successful contract renewal negotiations involves scoping, facility evaluation, price estimation, and negotiation preparation.

SCOPING is a key step in reaching your project goals. Correctly specifying the required space (how many cabinets), critical power, telecom networks, managed services, and cloud-migration tools is vital to planning a successful contract renewal. Contracting for more space and power than needed is the single largest source of colocation overspending, and accurately predicting that less capacity is needed going forward best positions users to reduce future costs.

Users should also specify their required reliability metrics, cooling density for new hardware installations, and network options to support ongoing operations.

Users should determine the certifications, audit/compliance processes, and security/managed services desired, especially in an environment where many companies are shrinking IT headcounts to control costs.

One scoping task often overlooked is forecasting likely growth, which is difficult but essential. Managers should evaluate their needs over both a short-term period of 2-4 years and a longer horizon of 5-7 years. Finally, budget constraints should be considered.

FACILITY EVALUATION involves measuring your existing colo facility and provider against your future needs, typically answering the following questions:

• Does the facility provide sufficient capacity (space and power) for current and long-term needs?

• Does the facility provide the reliability, cooling density, telecom providers, and network latencies desired for the foreseeable future?

• Does the existing provider meet minimum supplier requirements (facility operations, financial stability, certifications, audit/compliance assistance, managed services expertise)?

• Does the facility offer "direct connect" circuits to public cloud providers, private cloud services to assist in a gradual conversion to cloud, or public cloud presence within their data center campus or metro area, each smoothing the process for future cloud adoption?

PRICE ESTIMATION establishes local market rates for similar colo space and services. Many customers can get significant rate reductions for renewals by discussing lower prevailing market rates with their existing colo provider, but only if presented wisely. This is typically most effective when the pricing discussion occurs well in advance of the existing contract expiration, when there is still ample time to threaten a relocation.

Data center managers can obtain market pricing by initiating calls with sales reps for alternative colo facilities, describing 6-8 scoping parameters (physical size, critical power, power growth, reliability needs, telecom circuits, managed services, unusual critical systems requirements, etc.). Third-party advisors/brokers can also provide market pricing, conserving the data center manager's time (and anonymity, to avoid a barrage of sales calls) in the research process.

Many colo new customer proposals are 20-30% lower than existing contract pricing for a similar quality facility in the same metro area. If your existing colo suite is in a high-cost location (e.g. San Jose,

Google, Microsoft and Amazon have all purchased land for data centers at the Agriport A7 businesspark in Medemblik, The Netherlands.

Calif.), expand the list of colo facilities for price comparison to include regional low-cost locations like Phoenix.

If your project exceeds a megawatt of critical power, you may wish to complete a formal Request for Proposal process to a few providers including the incumbent, sending a clear signal that you are seriously evaluating relocation options.

During this process, instruct your data center operations team not to discuss the planned renewal with the incumbent provider's staff. Sometimes your "contract lead" is making significant progress on successfully negotiating improved colo renewal terms when a local IT staffer shares leverage-killing feedback with the colo provider's team such as "we would incur $5 million in unbudgeted move costs."

NEGOTIATION PREPARATION is vital to successfully obtaining desired renewal terms. The two most significant sources of value improvement are space and power quantity reductions and rate reductions.

Quantify the minimum and likely quantities of space and power actually needed during the new contract term. Many users can reduce overall costs by giving back space and power to the colo provider when combined with quantity flexibility going forward.

For most users, excepting those in capacity-constrained locations or with high growth forecasts, request only the quantity of space and power actually needed for the first two years of the new contract term, coupled with an expansion option to get more space and power if needs grow over time. For example, you could reduce your commitment by 200 kW and 30 cabinet positions from your currently contracted amounts (if those are surplus today), but get an expansion option allowing you to add back those cabinet positions and 200 kW if needed in the future. For many users, space needs are decreasing while server densities are increasing, so less physical space is needed than before to achieve the same overall computing capacity.

This "right sizing" of cage/suite specifications is typically the largest source of renewal cost reductions. Don't assume that the provider can't take back space and reduce power, as they usually prefer retaining most of your business to losing all of it.

Request lower unit pricing, which is usually charged in $ per kW of critical power. Discuss with your provider that overall market pricing has decreased since the last contract was signed (assuming you're in a location - like most - with decreasing rates). A twist on decreasing unit costs includes densifying the electrical/cooling capacity delivered to the existing premises, as it is usually cheaper for the provider to deliver additional power without requiring additional space, subject to cooling limitations.

To improve contract flexibility, enterprises should seek future contraction options for both space and power. As future needs for both are uncertain, especially in later contract years, ask for the ability to partially reduce space and power commitments after the third year of a renewal. Even when users must pay a modest space reduction fee, cost savings can be substantial. This footprint shrinkage model often dovetails with users' plans to migrate workloads to public cloud.

Start the negotiation process early, allowing plenty of time for back-and-forth discussions. Patient negotiators do better! Seek concessions multiple times; some colo providers decline initial concession requests, only giving serious consideration after the customer negotiates in earnest.

Additional Strategies to Improve Value

If the colo provider won't reduce occupancy rates, seek several months "free rent" upon the new term commencement, since some providers will grant incentives to secure a long-term renewal. In other cases, providers are willing to increase the quantity of space or critical power delivered or provide more managed services (private cloud, professional services, free cross-connects, etc.) for the same total cost, providing better overall value.

If operating efficiencies have improved or electricity pricing has decreased, seek a reduction in PUE ratio or the electricity pass-through rate, delivering line item savings.

Seek reductions in rates for blended telecom circuits in renewals. At many large colocation facilities, new telecom carriers with low pricing have recently installed lit circuits into meet-me rooms, and colo providers have lowered their aggregate costs for blended internet capacity. (Also, seek reductions in your third-party telecom circuit costs, leveraging the aggressiveness of upstart carriers to reduce pricing from incumbent carriers, or consider switching carriers.)

Seek reductions in cross-connect fees; colo providers have usually fully amortized their costs for meet-me room cross-connects during the initial contract period.

Request spend-shift rights to move spending from colo occupancy charges to other services or locations. For example, a customer could get pre-approval to shift 50% of monthly charges into managed services or private cloud from the provider. This shrinks colo spending and readies enterprise applications for future migration to public cloud, all within the physical confines (and, therefore, audit/compliance control) of your colo premises.

Spend-shift rights can also cover workloads moves to other facilities operated by that colo provider - such as international - or to locations with lower utility or telecom rates, reduced latency, or better suitability for business continuity. Leading colocation providers have significantly improved their private cloud and migration tools lately, assisting corporate customers evaluating public cloud adoption.

Enterprises can also improve service level agreement terms during contract renewals. Some customers rush SLA reviews during their initial contract execution, and now wish to tighten trigger definitions, increase breach credits, and improve cancellation options for downtime events.

Enterprises can also seek cost reductions before current contracts expire, usually in conjunction with extending contract durations or adding capacity or new managed services.

At older facilities, review contract language and search for capital expenditure sharing requirements that may be triggered by future replacements of major critical systems components like UPS modules, chillers, cooling towers, or CRACs. Renewals are an opportunity to remove any onerous reimbursement provisions, which can arrive years later as unanticipated (and unbudgeted) costs.

If operating efficiencies have improved or electricity pricing has decreased, seek a reduction in PUE ratio or the electricity pass-through rate, delivering line item savings.

Use the calendar intelligently since some colo providers are eager to "make their sales numbers" near the end of a quarter or fiscal year. Suggest an additional "discount" if a renewal is signed by year end. However, don't promise a signature date and miss it, which creates ill will with the provider.

Engage an experienced advisor/broker to assist in the renewal process. Advisor/broker fees are paid by the colo provider (rather than the enterprise customer), and those fees are typically far lower than the net contract savings realized by the customer. Some data center managers realize that they are at a market knowledge and negotiating experience disadvantage during colo renewals, plus advisors help conserve a busy manager's time.

Inform your corporate legal several weeks in advance of the renewal process, so they can provide contract review when needed. Inform IT procurement and senior IT management if they will need to sign off on renegotiated terms to avoid unnecessary delays.

Not all renewal goals are financial, though, and a contract renewal is also a great opportunity to improve the overall relationship with the colo provider, which can deliver operational benefits. Managers are encouraged to explore ways to improve the provider relationship and modify business practices or communications in a win-win manner.

Finally, document your planning process, quantify the savings to your organization, and note contract improvements achieved through your successful plan execution. Sophisticated data center managers can get credit from IT management for preparing and executing a successful renewal plan.

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