BUILDING CONNECTIVITY

CELL TOWER REITS' EXTENSIVE EXPANSION

Historically, certain segments in real estate have enhanced returns and diversified portfolios, by offering exposure to long-term growth trends absent in conventional sectors. Among these is the cell tower domain. This article provides insights into this focused yet expansive market, which is capitalizing on the thriving digital economy. It also highlights the publicly traded Real Estate Investment Trusts (REITs) active in the cell tower sector.

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Understanding Cell Towers

Cell towers are tall vertical steel structures that are strategically installed on land and buildings. Their purpose is to facilitate seamless communication between mobile phones and other wireless devices. They are crucial for wireless communication as they serve as the receivers for invisible signals known as radio waves. Mobile devices transmit these signals, which are then captured by the antennas or radios mounted on top of the towers. To ensure connectivity, the towers are connected to different wireless networks and the Internet through coaxial or fiber cabling located at the base.

There are two types of cell towers, macro cell towers and small cell towers: macro cell towers provide broad coverage across expansive regions, whereas small cell towers are intended to deliver focused coverage and enhance capacity in densely populated areas. Both tower types are crucial for establishing a smooth and dependable wireless network experience.

Owners and Tenants

The three largest companies in the sector are American Tower (AMT), Crown Castle International Corp. (CCI), and SBA Communications (SBAC). Each company specializes in owning and managing the cell tower structures and land, and is also responsible for their construction, maintenance, and generating income through leasing arrangements. High barriers to entry create an embedded moat for the owners already in the market, as building a cell tower is a complex process that requires permits, entitlements, approvals, and established relationships with carriers. AMT and SBAC own cell tower portfolios in North America, Europe, South America, Latin America, and most recently Asia-Pacific, while CCI is singularly focused on the U.S. market.

Wireless telecommunications companies lease space on cell towers to install their equipment and antennas, allowing them to provide wireless services to their customers. Examples of these tenants include AT&T or Verizon in the U.S.; Bell, TELUS, and Rogers in Canada; Deutsche Telekom, Orange, Vodafone, BT, and Telefonica in Europe; Telefonica, America Mobiveil, and Millicom in Latin America; or Claro, Movistar, and Tigo in South America. It is noteworthy that these are the largest mobile wireless carriers in the world, so the tenant credit for the cell tower sector is very strong. In some cases, cell towers are leased to government agencies or private organizations for public safety communications or specialized wireless services.

Market Profile

The market cap for cell tower REITs is presently valued at $140 billion[1] The three largest cell tower companies previously mentioned are all publicly traded REITS:

AMT made its conversion to a REIT in 2012, followed by CCI at the beginning of 2014, and SBAC in 2017. These cell tower REITs play a crucial role in the telecommunications infrastructure industry, offering investment opportunities in the rapidly expanding digital economy. AMT and SBAC have reoriented their capital allocation strategies to prioritize international acquisitions and development, while AMT recently started investing in data centres via their takeover of CoreSite. On the other hand, CCI is maintaining its focus on directing significant funds into fiber investments as a crucial aspect of its small cell antenna strategy.[2]

Furthermore, over the past 20 years, the cell tower sector (defined as AMT, CCI and SBAC) has outperformed the U.S. REIT market and the S&P 500 Index, delivering a 17.3% annualized total return[3] Partly contributing to cell tower REIT outperformance is their ability to deliver mid-single digit organic tenant billings growth annually, which leads to attractive earnings growth relative to traditional property types.

From a valuation point of view, we estimate that the sector is presently trading at a discount of 35%, which is our estimate of fair market value using a 50/50 blend of cash flow and net asset value.[4]

Mergers and Acquisitions in 2022[5]

Region	Announcement	Company	Acquirer	Country	Tower Sites
APAC	April 2022	MACQUARIE	Australia Tower Network	Australia	2,000
APAC	March 2022	NTT docomo	JTOWER	Japan	6,002
APAC	March 2022		EDOTCO	Indonesia	1,021
Europe	March 2022		DIGITALBRIDGE	Belgium	3,322
Europe	March 2022	cellnex	PHOENIX TOWER INTERNATIONAL	France	2,000
Europe	January 2022	Telia Company	alecta Brookfield	Sweden	3,800
LatAm	February 2022	3TS	atp	Columbia Peru Ecuador Paraguay	~400
LatAm	January 2022	GTS Grupo TorreSur	IHS	Brazil	2,115
North America	April 2022	TOWER VENTURES	PHOENIX TOWER INTERNATIONAL	U.S.	202

Market Demand Drivers

The exponentially growing cell tower sector is a direct result of the increasing long-term demand for wireless coverage and capacity, with the transition to 5G and the expansion of existing 4G networks (before it is replaced by 5G). This sustained need is projected to drive the requirement for macro and small cell sites on towers, rooftops, and other structures in the foreseeable future.

Current leasing activity for macro cell towers in the U.S. is experiencing a positive impact from the deployment of the 5G spectrum by wireless carriers. With its ability to provide faster data speeds, lower latency, and support for a greater number of connected devices, 5G is expected to drive mid-single digit net operating income growth for cell tower owners annually, following the trend observed in the industry's history.

Potential Market Risks

The biggest risk associated with the cell tower sector includes wireless carrier consolidation. For example, when tenants leave a tower, less rent is paid, and the cell tower owners then experience a drop in revenue. However, an offset to this risk is that cells towers end up with a stronger wireless carrier, such that there is less enterprise risk around those cash flows, and potential for future growth once those colocations get consolidated and the carrier that is larger will grow as the technology evolves.

What makes cell tower REITs a good investment?

Investing in cell tower REITs offers a compelling opportunity. These REITs provide stable cash flows through master lease agreements with cash flow guaranteed from rental payments, coupled with a high rate of growth, driven by rent escalations embedded in the leases to account for equipment updates and colocation growth. Their non-cyclical nature, tied to ongoing technology advancements, ensures steady demand through economic cycles. Strong balance sheets and favourable economics in cell tower development enhance their appeal, while share buybacks contribute further to their attractiveness.

As an example, we see that the superior business model of cell tower REITs ensures high growth with minimal leakage, leading to significant outperformance. Over the past 20 years, SBAC, AMT and CCI have delivered a 23.3%, 16.3% and 14.1%, annualized total returns, respectively, compared to the U.S. REIT market of 7.4%.[6] Additionally, cell tower leases typically span from five to 15 years and feature annual rent increases.

International Expansion

The prospect of international expansion in cell tower development holds immense promise. Emerging markets and technology-lagging developed markets present ample opportunities to bridge the gap and establish 21st-century wireless networks. With many regions, including North America, transitioning to 5G while others remain on 3G, the need to upgrade and modernize is evident. These national network transformations are poised to generate substantial investment demands, compelling carriers, and stakeholders to infuse billions into tower construction, fiber deployment, and equipment installation. The process of expanding and rejuvenating outdated wireless networks is projected to sustain a decade-long stream of investment possibilities, particularly in markets beyond North America. This expansion trajectory, marked by the coexistence of 5G building, 4G enhancement, and 3G replacement, underscores a pivotal phase in the global telecommunications landscape. Lastly, yields on cost are frequently in the low-double digit range which makes development of towers in South America, Latin America and Asia-Pacific and attractive endeavor.

Conclusion

In conclusion, investing in cell tower REITs presents a strategic opportunity for diversification and enhanced returns within the realm of real estate. With the ongoing surge in demand driven by technological advancements and the imperative for reliable infrastructure, these REITs offer a dual advantage of consistent cash flow and long-term growth potential. The contractual nature of their business model, involving long-term lease agreements with wireless service providers, ensures stability and resilience against market fluctuations. As communication technologies continue to evolve, investing in cell tower REITs becomes an attractive prospect, aligning with the persistent need for seamless connectivity in our increasingly digital world.

Sources:

1. Data sourced from Bloomberg (USD) as of 09/30/2023.
2. Green Street 2023 Presentation.
3. Data sourced from Bloomberg (USD) as of 10/01/2003 to 09/30/2023. 16.6% is a blended return based on the equity market capitalizations of AMT, CCI and SBAC.
4. Internal Valuations as computed by Hazelview Securities Inc. as of 09/30/2023.
5. RBC Capital Markets, RBC Towers – Global M&A and Operating Review, 04/25/2022.
6. Data sourced from Bloomberg (USD) as of 08/29/2003 to 09/30/2023 defined as EPRA NAREIT U.S. Total Return Index.