Securitized Products Special Topics

Cell Towers: Lender-Friendly Features Dovetail with Secular Tailwinds

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Tower ABS May Offer a Small Refuge Amid Upheaval in Other CRE Sectors

Several salient features of cell tower leases and tower ABS real estate security underscore the potential resiliency of the segment's collateral in a more challenging economic environment. For example, non-cancellable leases and rent escalators are prevalent in the tower sector, providing some cashflow stability and inflation protection. In turn, tower ABS trusts may have both mortgage security and equity pledges on the borrower's interest, streamlining lender's access to the collateral in distress. Such lender-friendly aspects contrast with common features in other commercial real estate segments. In office, landlords and lenders are now regularly contending with tenants exercising early termination options.[1] Separately, CRE lenders increasingly may be interested in obtaining both mortgage and equity security on deals' collateral as defaults pick up.[2] All told, investors may find tower exposure appealing as they look to diversify portfolios. Interestingly, the just-priced American Tower Trust series 2023-1 upsized to $1.3 billion from $500 million. The approximately five-year benchmark triple-A class of the new series priced at I+130bp, yielding 5.49%.

Tower ABS favorable lease and security features come against a backdrop of secular tailwinds for the sector. Tower landlords should continue to benefit from robust tenant demand on the heels of data traffic growth. Mobile data traffic should grow 23% per year through 2028 in North America, according to current estimates from Ericsson Mobility Report. Migration to unlimited mobile plans and increasing usage of video streaming are some of the drivers underpinning mobile data demand growth.

Tower ABS Feature Some Familiar, But Mostly Unique Collateral Aspects

We find the following aspects relevant in looking at tower ABS collateral:

- **Non-cancelable leases.** The absence of early termination options on the typical lease of tower tenants should support cashflow predictability. Tower pools usually have a remaining current term of around five years, according to rating agencies. In American Tower 2023-1A, for example, the weighted average remaining term is 6.3 years.

1 "Office Modifications: 285 Madison Could Offer a Blueprint for More to Come," CMBS Credit Focus, Academy Securities, October 27, 2022
2 "Equity Pledges: Hotel Bossert Spotlights Dual Collateralized Loans," CMBS Credit Focus, Academy Securities, February 23, 2023

- **Rent escalation provisions.** Annual escalators are also common across tower leases. Escalators usually hover around 3-4%. Such Contractually negotiated rent increases could shield property NOIs from rising expenses. Still, in an elevated inflation environment the typical escalator may offer only limited protection, similar to our findings on step-up leasing provisions in other property segments.[3] Interestingly, non-US tower leases do include CPI-based escalators, and may also pass through a portion of the operating expenses to the tenants. US towers have largely fixed operating costs. Several cost items appear sensitive to inflationary pressures, including utilities and fuel, insurance, and real estate taxes. Maintenance capex can represent only <1% of revenue, according to market participants.

- **Minimal land value.** The tower structure and tenant leases usually comprise most of the collateral value, rather than the underlying ground. The location of many towers on farmland, or other undeveloped areas readily explains this. Towers' minimal land value contrasts with other CRE properties, especially those in core urban areas; Land may comprise a significant chunk of the collateral value, and landlords may even be inclined to fully raze the improvements if a completely new building makes economic sense. We see pros and cons in towers' unique land/improvement composition. On the one hand, towers may have very limited "alternative use", echoing concerns around other highly rural properties, in segments such as data centers, industrial, or retail. On the other hand, the low land value may alleviate potential frictions between ground landlords and tower leaseholders, of the type that may afflict urban properties on highly valued ground.[4] Tower ground leases are generally long-term, are assignable if the land is sold, and historically had high renewal rates, according to rating agencies.

- **Dual collateralized loans.** Some tower ABS deals appear to have equity pledges on the borrower as an additional security beyond the mortgage security. This allows the lenders to foreclose on the ownership of the issuers in an event of default. Such dual collateralized loan can provide a powerful investor protection, as we discussed in a recent report. Initiating equity pledge foreclosures instead of mortgage ones can streamline recovery timelines, avoid potential costly transfer taxes, and incentivize borrowers to remain cooperative when they can.

- **Property substitution.** All tower ABS deals appear to allow property substitutions, according to presales. This raises a concern about issuer "cherry picking" across portfolios over time, potentially leaving pools with inferior, or technologically obsolete sites. With thousands of sites across pools, as Figure 1 shows, investors may find it particularly challenging to track the quality of substituted assets. To be sure, deal documents contain elaborate list of release or substitution conditions. For example, many specific attributes of the remaining sites following release or substitution should remain constant, with examples including the weighted average remaining term (excluding extensions) of all tenant leases, or the percentage of sites located in the top 100 basic trading areas (BTAs) (by population).

3 "Inflation-Resistant Leases: Rent Steps Offer Some Revenue Protection, though Not Much," CMBS Special Topics, Academy Securities, June 8, 2022
4 "The Road to Conversion: Consider Ground Leases and ARD Loans in Office Analysis," CMBS Credit Focus, Academy Securities, January 5, 2023

Figure 1. Tower ABS Pool Characteristics

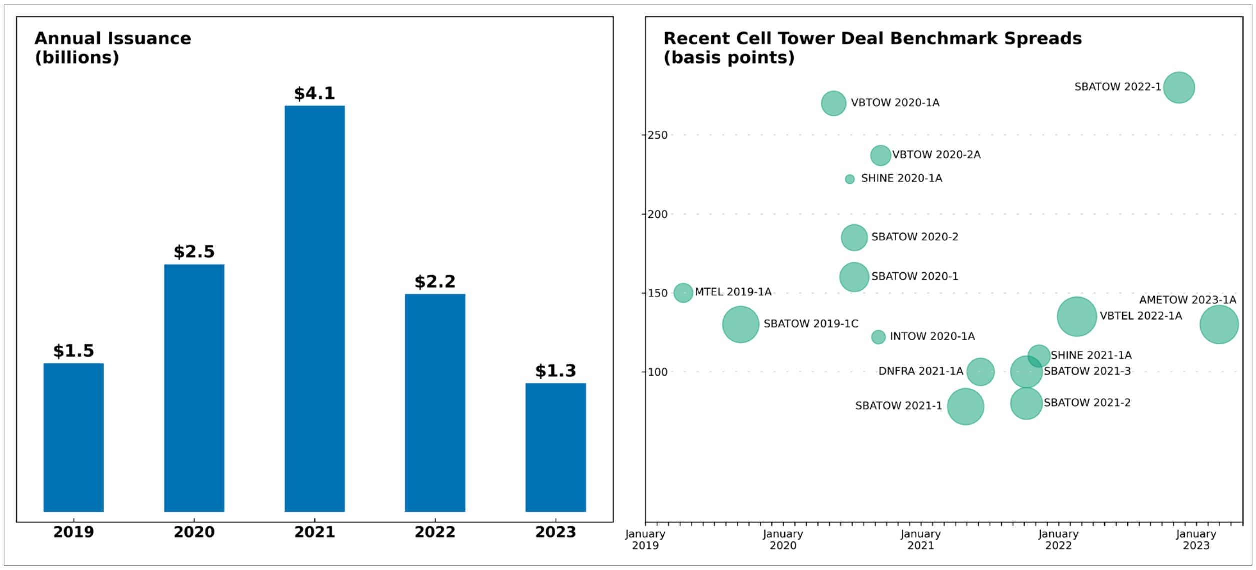
Issuer	American Tower Trust I	SBA Tower Trust	Vertical Bridge
Series	2023-1	2022-1	2022-1
Closing Date	March 2023	November 2022	February 2022
Trust Balance ($MM)	1,894.9	7,062.5	1,419.9
Annualized Run Rate Net Cash Flow (ARRNCF, $MM)	600.6	861.2	115.5
Number of Sites	5,036	9,906	3,526
Number of Tenants per Site	2.8	2.2	1.6
Owned Sites (% of ARRNCF)	48.7	13.3	11.0
Leased/Easement Sites (% of ARRNCF)	51.3	86.7	89.0
Top 100 BTAs (% of ARRNCF)	70.6	57.8	49.9
Asset Substitution	Yes	Yes	Yes

Source: Rating Agencies and Academy Securities

Tower ABS Issuance Still Very Limited

A clear challenge for gaining meaningful exposure to tower ABS is the sector's small size and relatively sporadic issuance. Tower ABS priced $2.2 billion in 2022 across two transactions (Figure 2). This marked a drop from $4.1 billion issuance across five deals in 2021. The American Tower deal last week marked the first 2023 issuance in the sector. Interestingly, some tower ABS deal offered subordinated classes. For example, Vertical Bridge 2022-1 offered last year a $202 million triple-B class, and $242 million double-B tranche.

Figure 2. Tower ABS Issuance and Spreads



Source: Bloomberg and Academy Securities

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