How Is the Current Economy Impacting the Tower Business?

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With the U.S. economy being buffeted by inflation and rising interest rates, we wanted to gauge the impact on the tower business, both in leasing operations and M&A activity. *Inside Towers* reached out to Michael DeMita, Chief Executive Officer at Tower Capital Advisors, LLC for his perspectives. We asked Clayton Funk, Managing Director at Houlihan Lokey to comment, as well.

How does inflation affect tower growth revenues, i.e., fixed escalators in North America vs CPI-indexed escalators internationally?

DeMita: Inflation certainly puts pressure on tower companies to find a way to increase profits as lease escalations are falling behind the current inflation rate. The average escalation in carrier leases and tower ground leases is just under 3 percent per year/15 percent per term and has been 2 percent per year/10 percent per term for new builds for several years. Without lease-up or amendment activity, though still quite active, existing revenue is losing ground every year.

Domestic tower companies are not changing their business model, but we have seen some middle market players expanding abroad where lease and tower acquisition multiples are low and index-based escalations more common.

Funk: Nothing has changed. The stock market has its ups and downs. Tower company organic growth is strong and is ahead of inflation. With another interest rate hike looming, and fixed annual escalators in MLAs at 2-3 percent, though, towercos are going to have a tough time raising monthly lease rates at the inflation rate. But there is so much investor money available, tower deals are still happening.

Are declining stock prices affecting tower valuations? Do the towercos change anything in their business model, even with long term MLAs in place?

DeMita: The P/E ratios of the public tower companies are above the average multiple we see on tower acquisition deals. Losses in the market might be pushing some one-off and smaller private tower owners to sell. Larger private equity backed towercos still have money to invest and have continued to press their multiples higher as alternate investments with this level of security are hard to find, depending on their portfolios size.

Index-based escalation provisions in MLAs are not common. Our data suggests only 2-3 percent of all domestic wireless lease types have indexed escalation provisions.

Funk: The public tower companies are sensitive to their stock prices, but we don't see tower sale prices changing in the private market. While the public tower companies have traded off their 52-week highs, nothing has changed in the M&A market and valuations remain at historically high levels.

What is the impact of higher interest rates on deal making?

DeMita: All acquisitions are done with some combination of debt and equity and, to my knowledge, the debt facilities of buyers all float over an index, typically LIBOR. Hedging a portfolio against this level of inflation is likely unfeasible or cost prohibitive at a minimum. So to the extent buyers' cost of funds increase, something has to eventually give, either on the expected equity returns or more likely, on the multiples that are being offered to sellers. A reduction in the number of buyers in the space may also put downward pressure on prices.

The tower side seems more active at the moment with one-off owners coming to market and the lease/easement acquisition business remaining vibrant. Closings of easement/lease purchases may slow as inflation continues to put stress on commercial real estate owners and their lenders, who must consent to the sale.

We still see tower multiples in the high 20's to low 30's as offered by the public and better capitalized private buyers – and even higher on larger, multi-asset deals. Ground leases under towers or rooftop leases are hovering at or just above 20x if the trade is sizable but pricing is very much escalator and upside (expansion of easement area/marketing rights) dependent.

Funk: There has been some slowdown, yet I wouldn't necessarily say it is due to higher interest rates but more so on the timing. Some owners are not ready to sell due to experiencing great lease-up or wanting to deploy more of their investor's committed capital. We're not as busy as we have been historically at this time of the year, but the pipeline is robust. There are conversations around a number of prospective digital infrastructure sales. Expect a flurry of deals in the second half of the year.

By John Celentano, *Inside Towers* Business Editor

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