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Tower Sale and Leaseback Transactions – Some Key Considerations for Operators and Tower Companies

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Last year, PT Indosat Tbk ("Indosat") sold and leased back 2,500 towers to PT Tower Bersama Infrastructure Tbk for over US$500 million, in what was the largest tower sale and leaseback transaction at the time in Indonesia. The transaction allowed Indosat to monetize a portion of its noncore assets, while preserving flexibility for it to further reduce costs through network modernization and the sharing of its radio access network with other operators.

These kind of outcomes have led to Sale and Leaseback transactions becoming increasingly popular with leading telecommunications operators. The transactions often involve the sale of towers to an independent tower company and the leaseback of space on each sold tower on which the operator's active telecommunications equipment is located

Tower sales from telecommunications operators to independent tower companies can be of substantial benefit to both parties. By monetizing tower assets through a tower sale, operators can increase liquidity, reduce the financial and human resources dedicated to tower maintenance, focus on their core business and, in some cases, use the transaction to establish a benchmark valuation for their tower assets. By running a sale process that takes account of an independent tower company's resources and expertise in managing tower assets, telecommunications operators can also seek to choose a long-term infrastructure partner that can assist with ancillary functions and services, such as regular and emergency maintenance of telecommunications equipment and, often critical, back-up generators. For telecommunications operators which have wide spread coverage in remote geographical areas, such services can be of significant benefit.

For independent tower companies, substantial sale and leaseback transactions can help build or enhance relationships with major operators that become anchor tenants on the newly acquired towers. Independent tower company buyers may also be in a better position than telecommunications operators to maximize the value of tower assets by increasing the number of tenancies, or co-locations, at each tower, thereby promoting efficient utilization of each tower and increasing the size and diversity of their tower portfolio. Increasing co-locations with different tenants also helps diversify credit risk for the tower company.

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In the context of a sale and leaseback transaction, there are a number of key considerations for both sellers and buyers as they transition into the lessor-lessee relationship.

Key considerations

In a major tower sale and leaseback transaction, a telecommunications operator is disposing of a key part of its telecommunications network infrastructure, and therefore it maintains a vested interest in the long term, reliable operation of the towers after the sale while seeking to lease back the towers at a reasonable, stable cost. The tower company will seek to ensure the certainty of its revenue stream under the master lease agreement, preserve its ability to maximize the number of tenants on each tower while minimizing capital and operating expenditures and limiting the potential for liabilities under the master lease agreement including for breach thereof. Key priorities include the following:

***Network Integrity*:**

Preventing disruptions to the telecommunications operator's equipment and quickly remedying any issues that arise will be a key priority for the operator. The operator and the tower company will often carefully negotiate a set of maintenance and service obligations for the tower, land, and where applicable, ancillary equipment such as generators and utility connections. An operator will typically seek emergency access rights so that it can access its equipment as needed on short notice. The tower company, on the other hand, will be focused on ensuring that such access does not give rise to the risk of damage to the tower or interfere with the equipment of other users who may co-locate on the site.

The most contentious provisions relating to network disruptions, however, are the maintenance standards and "downtime" provisions i.e., the operator's equipment being off air. In the event actions or omissions by the tower company or other users, such as a failure to comply with maintenance and service obligations, result in downtime, the operator will want to impose penalties on the tower company. The amount of the penalty, grace period and whether the penalty is payable in the form of cash or credits are among the issues that should be carefully considered in negotiating these provisions. An operator may also consider potential interim solutions in the event of downtime, such as mobile tower facilities, which can often be provided by the tower company. Ultimately, if an agreed upon period of downtime lapses, an operator may seek to relocate its equipment to another tower at the tower company's cost. The tower company will want to clearly define the types of events and failures that can trigger a downtime obligation. To the extent the tower company uses third party maintenance service providers, it will seek to gain back-to-back protections under its service agreements with such providers.

The operator and tower company also will enter into arrangements on how to resolve claims that one tenant's equipment is causing interference with another tenant's equipment. Most commonly, where the equipment of tenants is interfering with each other, the tenant that placed its equipment on the tower later bears the burden of removing its equipment if the interference cannot be resolved. For an operator seeking treatment as an anchor tenant, it will typically seek to make clear

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that its equipment should be treated as having been on the tower first for purposes of the interference provisions. The tower company will need to carefully evaluate whether such commitment is consistent with its obligations to other tenants. Also important is specifying how installing new equipment or moving or replacing equipment can affect the interference provisions.

Maintain structural integrity:

An operator will need to carefully evaluate the structural integrity of its towers before engaging in a sale transaction, so that it can assess the types of commitments with regard to structural integrity that are appropriate to seek from the tower company on an ongoing basis following the sale. For example, if the operator is not certain that it can commit as part of the sale process that the towers meet a specified strength and loading standard, then the tower company will be unlikely to accept an obligation to ensure that the towers meet such standards during the term of the lease. On the other hand, whether the towers being sold are of adequate strength is one of the fundamental due diligence considerations for a tower company. The tower company will want to know that the towers meet an agreed upon standard (e.g., ANSI/TIA-G) at the time of sale. Once it takes ownership of the tower, the tower company will have primary responsibility for maintaining the structural integrity of the tower and would seek to minimize any structural enhancement costs it incurs. For towers that do not meet the agreed standard, the parties will need to agree on the implications, which could include adjustments to the valuation of the relevant tower or reimbursement of the cost of remediation. The parties should also consider who bears the risk of any loss that results to the operator or tower company prior to such remediation. There is significant room for compromise in this area. The parties can agree, for example, that they will share the cost of bringing the towers up to an agreed standard, and also share the risks of any failures in the interim. Careful deliberation is critical on these matters.

In addition, as the tower company adds additional tenants on a tower, additional stresses can be placed on the tower which require structural enhancements to be made to maintain structural integrity. An operator will typically seek to ensure that a system is in place allowing it to evaluate the structural integrity of a tower after a new tenant is added and ensure the tower company implements any structural enhancements required as a result of the installation of another tenant's equipment.

Ensure compliance with employment, health, safety and environmental best practices:

An operator may have legal and reputational concerns even after the sale of its towers, and it may want to ensure that, as the anchor tenant on the tower, it is not adversely affected by the actions of the tower company at a site on which it still has equipment. Accordingly, an operator may require that the tower company retain certain of the operator's tower-division employees for a specified period after the sale, with at least as favorable compensation, and that the tower company complies with health, safety and environmental laws and procedures in the course of maintaining or performing work at a site.

Future Network Flexibility:

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- *Maintaining the flexibility to install, replace and modify equipment*. When an operator is selling a significant portion of its towers network, it will often have a need to maintain increased flexibility to install, replace or modify equipment on a tower.
- *Defining the tenancy:* In a typical lease agreement, a tenancy will include a defined number of antennas/equipment, for example, three GSM/sectoral antennas and two microwave antennas. An operator will want to consider whether the antennas on its towers may exceed this threshold and if necessary, whether it should adjust the definition of a tenancy to include any space occupied by the operator as of a certain date, such as the closing date for the tower sale transaction. Obviously, increasing the space available for a single tenancy will likely impact the pricing of the sale, since additional antennas affect the space available for future co-locations. In either case, it is important for both parties to clearly define the space leased on the tower and land as well as any flexibility that will be permitted to install, replace or modify equipment within such space. As an anchor tenant, the operator may also seek a buffer of additional space since the dimensions of new equipment may differ from those of older equipment. In many tower lease transactions (in India for example) such buffers are utilized to provide the operator with increased flexibility.
- *Modernization:* A radio access network, or RAN, modernization can involve a significant degree of additional complexity because it may require the removal of existing antennas from the tower and the installation of new, larger antennas at a different height on the tower (this may also reduce the overall number of antennas on a tower), the replacement of traditional heavy feeder cables with lighter, next generation cables, the installation of heavy remote radio units adjacent to antennas on the tower and the replacement of shelters with air conditioning with smaller and more energy efficient cabinets. These activities can affect both the usage of space on the tower and land (as equipment may be moved around) and the loading and structural integrity on a tower. A typical tower lease agreement, which is not in the context of a sale and leaseback transaction, may not provide the operator with the flexibility to conduct RAN modernizations without consent from the lessor. In the context of a tower sale, an operator may have the leverage to negotiate future flexibility to conduct RAN modernizations without the consent of buyer. However, given the tower company's need for certainty about the space that is available for lease to third party tenants, such negotiations can be complex and time-consuming. An operator would need to work with its operational and legal teams to determine carefully the type of flexibility it will require so that appropriate provisions can be included in the master lease agreement. A tower company, on the other hand, will want to carefully evaluate such proposals and seek to limit movement of equipment on the tower and adverse changes to the loading of the tower, as well as potentially provide for adjustments to lease fees as part of any such requirements.

Efficient use of space on a tower:

In contrast to the operator's need to maintain flexibility, the tower company will seek to ensure that it has certainty regarding the space that is available to lease to other tenants going forward. Accordingly, an operator's request for flexibility to increase space on the tower or land or to move equipment around the tower can pose significant challenges. The tower company will want to

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maintain the right to ensure that space is used efficiently on the tower. This is especially the case where the operator may have never co-located other users prior to the transaction, and may not have installed its equipment in the most space-efficient manner. Accordingly, the tower company may require the right to move antennas and other equipment into specific "bands" of site space on a tower (so long as network integrity is not adversely affected).

***Network Sharing*:**

Network sharing and other cooperative models are gaining favor, given their ability to reduce operator's capital and operating expenditure and expand network coverage. An operator should carefully consider the type of network sharing arrangements it has entered into and intends to enter into so that appropriate provisions can be discussed with the tower company. Tower companies will generally be resistant to a complete and unlimited right to network sharing given that it could adversely affect a key purpose for the sale and leaseback transaction, namely pursuing co-location revenue. If a tower company is prepared to allow network sharing, it will likely seek to carefully define what is allowed. For example, tower companies will want to limit network sharing arrangements to bona fide active equipment sharing so that the operator does not have the ability to effectively sub-lease passive infrastructure in competition with the tower company. Where network sharing is contemplated, the master lease agreement must be carefully drafted to define the types of permitted network sharing and ensure that the operator's network partner or network joint venture have the same rights as the operator under the master lease agreement. In addition, since the tower company's cost of capital and financing terms may be partly dependent on the operator's credit (given its anchor tenant position), the tower company will want to ensure that the operator is responsible for any defaults or breaches by the operator's network partners.

***Termination Rights*:**

In the context of a tower sale and leaseback transaction, the tower company (and by extension, its lenders) will be relying on the revenue stream provided under the master lease agreement, and as a result, will seek to limit the operator's ability to terminate the lease for a site under the master lease agreement. Accordingly, the operator will need to consider alternatives to termination that enable it to protect itself and incentivize the tower company's performance of its obligations under the master lease agreement. This may include "mandatory relocation" to a "replacement tower" following breaches and other events which prevent continued use of the tower. Determining which party bears the costs of such relocation, the cost of mobile towers used in the interim, and the terms and conditions applicable to the replacement tower are typically heavily negotiated and will depend on the circumstance leading to the relocation.

Discretionary Relocation:

In a typical tower lease agreement, a lessee may seek the right to relocate its equipment from one tower to another at its discretion. If agreed to by the tower company, such right will usually be subject to an aggregate limit. In the sale and leaseback context, anchor tenants often take the position that because they are providing the tower company with a guaranteed revenue stream

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under a long-term lease, they should have the right at their sole discretion, provided it is at their own cost, and subject of course to availability of space on such tower, to relocate equipment to another tower in the tower company's network, without any limitation. This right can be particularly valuable to an operator by enabling it to evolve its network over time in response to changing demographics as well as in the context of a RAN modernization and network sharing. A tower company, on the other hand, will want to limit this right in order to avoid the loss of co-location space on more valuable towers (e.g., in heavy traffic areas).

***Sale of Towers*:**

An operator has a vested interest in ensuring that it is comfortable with the skills and capabilities of the tower company, and operators often carefully consider counterparty risk when choosing a buyer of tower assets. Accordingly, an operator which is a major anchor tenant will typically seek to prevent the sale of towers and assignment of the master lease agreement by the tower company to inexperienced or undercapitalized third parties. In some transactions, operators will seek undertakings from the buyer's lenders that they will comply with these provisions, and otherwise honor the terms of the master lease agreement, in a foreclosure or other forced sale.

Lease and Maintenance Fees:

Consideration should be given to whether lease and maintenance fees will be fixed or subject to escalation, and if so, at what rate (e.g., at a rate based on the increase in the consumer price index of a relevant country). The operator should also carefully consider currency risk in the transaction. The operator will typically want the lease and maintenance fees to be denominated in the currency of its network revenues, while the tower company may insist on fees being denominated in the currency of its financing. The calculation of lease fees can be complex, especially where the telecommunications operator is reserving the right to install, move, change and replace equipment on the tower (e.g., in connection with a modernization program). The parties should also consider and set out the additional lease fees payable in the event that the operator installs equipment exceeding the standard tenancy specified in the master lease agreement.

Conclusion

In the context of a tower lease in connection with a sale and leaseback transaction, the considerations for both telecommunications operators and tower companies may differ from those in typical tower lease agreements. The operators are generally disposing of large parts of their networks and committing to long term leases of the sold towers and therefore often expect a greater degree of flexibility than may ordinarily be appropriate. Tower companies are paying not only for the towers but for a committed revenue stream and the ability to add co-locations to the tower, meaning that the valuation of the towers will be based on the net present value of future co-location revenue. However, in working together with the right team of internal and external professionals, telecommunications operators and tower companies can reach a compromise giving operators the required flexibility and cost efficiencies, while enabling tower companies to maximize the value from the acquired towers.

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