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Crown Castle's lead on tower deal may rest on REIT

By **Chris Nolter** Updated 06:50 PM, Sep-17-2013 ET

With **AT&T Inc.**'s wireless towers on the market, Crown Castle Inc.'s recent decision to accelerate its conversion to a real estate investment trust has drawn increased attention. The move to the tax-light structure could affect its approach to financing a purchase of AT&T's towers.

Becoming a REIT would place requirements on the wireless tower operator's cash deployments. However, it could also increase Crown Castle's access to the equity markets, which would help it bid for AT&T's assets without adding excessive leverage.

AT&T had hired bankers and made progress in marketing the towers, sources said. Though Bloomberg reported that the Dallas telecom is seeking $5 billion for the towers, one person said the first round of bids had occurred and that the price would be lower.

The portfolio includes about 11,000 towers that produce about $200 million in cash flow and represent one of the last major targets in the industry.

"I think Crown Castle is still in the driver's seat on the AT&T towers," Jonathan Schildkraut of **Evercore Partners Inc.** said.

"A contributing factor to the timing of this announcement may have been the likely need to raise equity to acquire [AT&T]'s Towers, and the rightful expectation that early REIT conversion would be positively received by the market," he said of Crown Castle's announcement in September that it would change its capital structure sooner than previously expected.

Schildkraut suggested that the final sale price may not represent the "true cost" of the towers. AT&T would like to keep the right to upgrade the towers, and would likely fold an agreement into the sale.

"Eighteen to 20 times cash flow will be the headline number," he said. "The true cost will include whatever upgrade rights AT&T is able to negotiate."

That would put the valuation at $3.6 billion to $4 billion.

Kevin Smithen of **Macquarie Capital** estimated that AT&T's towers could raise $4.5 billion to $5 billion, based on a multiple of $400,000 to $450,00 per tower.

There are other acquisitive tower operators. Earlier this month, rival **American Tower Corp.** agreed to pay $4.8 billion for **Global Tower Partners**, backed by **Macquarie Infrastructure Partners** Inc., Dutch pension fund manager PGGM BV and company management.

Moody's Investors Service analyst Gregory Fraser suggested that the timing of Crown Castle's announcement, just days after American Tower's latest deal, was not coincidental.

"Because American Tower is issuing a significant amount of debt to make this purchase, it has no more flexibility to make another large acquisition," he said. "With American Tower out of the running for a big acquisition, this means Crown will have a better chance of acquiring AT&T's towers."

American Tower touted its investment-grade balance sheet when it announced the deal for Global Tower, saying that its liquidity was one reason its bid prevailed.

Crown Castle, on the other hand, is speculative grade.

That could present problems when it comes to its REIT structure and financing something as big as the AT&T purchase.

"With rising interest rates, balance sheet matters more than ever, particularly with strategic activities," said **EA Markets LLC** co-founder Reuben Daniels, who advised American Tower on the Global Tower Partners deal. The New York investment bank, which is not part of a lending institution, advises clients on matters related to capital structure.

"There is a view today that money is cheap and will be plentiful for years to come," he said. "Once the tide of liquidity is withdrawn from the system, to paraphrase Warren Buffett, 'that's when you find out who is swimming naked.'/"

An investment-grade rating is "really important for a REIT," he said. The combination of high leverage and cash flow distribution requirements of a REIT can create "capital allocation hurdles," he said, noting that there are not many examples of low BB rated REITs.

"You can't do everything," Daniels explained. "A REIT conversion can change a company's priority of cash flow allocations for dividends, debt reduction, share repurchase, capital expenditure or acquisitions." If access to capital is reduced, management's ability to make capital allocation decisions can be "severely constrained."

Steven Marks of **Fitch Ratings Inc.** said that most of the REITs that his company rates are investment grade.

"There are a few reasons why that is," he explained, including that commercial real estate is an asset that can support leverage and most REITs have access to mortgages. They tend to access the bond market because they want to, not because they have to.

There is also the fact that REIT bond investors may be prohibited from buying securities issued below investment grade.

"A REIT typically only wants to issue bonds if it is investment grade," he said.

Moody's analyst Fraser noted that data center REITs **DuPont** Fabros Technology Inc. and **CyrusOne Inc.** are Ba1 and B1, respectively.

"It is not necessary for a REIT to be investment grade," he said.

In theory, a REIT structure should improve Crown's cost of capital to finance such a large asset purchase.

REITs enjoy substantial tax benefits, Fraser said, and a company's cash flow metrics should look a little better than the typical non-REIT that pays taxes.

Another benefit is that **real estate investment trusts** typically have a 39-year depreciation schedule, while non-REITs generally depreciate assets over 15 to 20 years.

"If you have a lower depreciation expense," he said, "this will boost your reported earnings."

Shifts in the market may also motivate Crown Castle to convert now.

REIT's high dividend yields appeal to equity investors, and often deliver higher valuation multiples.

"The window for that may be closing," Fraser said.

Tapering by the **Federal Reserve Board** could reduce Treasury prices and push yields higher. Investors who are now drawn to equity REITs could be drawn to government notes.

"You may see an outflow of investment from REITs to Treasuries," he said.

It could behoove Crown Castle to act now, while the markets are more receptive to REITs. Of course, the availability of AT&T's towers provides additional motivation.

Crown Castle declined to comment. AT&T did not respond to queries.