



STRUTT
& PARKER

Telecommunications Survey

2016



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WELCOME



As ever, I am delighted to introduce Strutt & Parker's Telecommunications Survey.

Our analysis covers over 6,000 telecoms sites and in the intervening period since our last survey, the market has lived up to its reputation for rapid change. However, it is remarkable how little the underlying issues and constraints have varied. Inadequate coverage and a lack of overall capacity remain key concerns for customers and operators alike and new technology is likely to increase pressure for sites.

There is often misinformation in this marketplace, but in this edition we hope to dispel some of the myths and identify new opportunities for landlords of telecoms leases.

ROBERT PAUL

Head of Strutt & Parker's Telecoms Group

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BACKGROUND & TECHNOLOGY

The race for 5G is on the horizon and will improve the speed at which data is transmitted, reducing latency and leading to greater efficiencies and possibilities. The Internet of Things (IoT) connects objects to networks and can exploit the data that is generated. For instance, a central heating thermostat being controlled from a mobile phone, or a car's brake discs being connected to the car dealership. Ofcom has said:

“The IoT will lead to the introduction of many new and innovative services. It will allow data to be transmitted between many different types of devices, improving the safety of transportation, reducing the consumption of energy and improving our health”.

IN 2015 THERE WERE AN ESTIMATED 5 BILLION IoT CONNECTIONS. THIS IS EXPECTED TO GROW TO 25 BILLION IN A MARKET WORTH SOME £2 TRILLION BY 2025.

Telecoms operators now wish to be regarded as the fourth utility, with associated compulsory powers and more favourable planning provisions, despite not being under the same regulatory constraints as the utility companies.

In November 2014, the Government agreed with the Mobile Operators Association (MOA) that operators would invest a further £5 billion into their networks by 2017. This followed a £150 million Government initiative in May 2013 to fill 600 identified 'not-spots', where there is essentially no mobile reception, sadly this resulted in the construction of only 15 new sites by the end of 2015 and approximately 40 in total.

Network consolidation continues apace, but there is relatively little evidence of operators rolling out new sites to provide coverage in these 'not-spots'. There is reason therefore to be concerned about the ability to provide coverage to 98% of the population (which Ofcom ambitiously proposed back in 2012), and further reason to doubt the appetite for investment in remote areas as the economics are not as attractive for the commercial operators.

There are still more mobile phones in active use than there are people in the UK. 93% of adults have a mobile phone and more than 60% use their mobile phone to access the internet. Broadband speeds have improved significantly since 2012; 34% of residential properties now use a superfast broadband connection at 30 megabytes per second (mbps) compared with only 13% in 2012, but PC internet usage at home has declined by 14% to an average of 29.8 hours per person per month as mobile internet usage increases to more than twice the PC usage figure.

The Ofcom Infrastructure Report 2015 provides an interesting snapshot of usage: 95% of UK households use mobile phones, 16% have no landline at all; 71% of businesses rate mobile phones as crucial or very important to their business. Currently, 99% of premises are covered outdoors by at least one Mobile Network Operator (MNO) and 93% are covered by all three of the MNOs that operate 2G networks. For 3G services, 88% of UK premises are covered outdoors by all four MNOs and 46% of premises have 4G coverage from Vodafone, EE and O2.

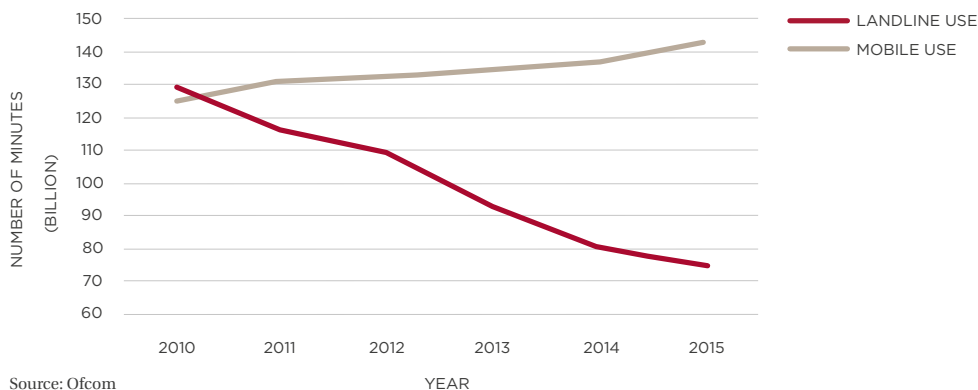


BACKGROUND & TECHNOLOGY

The number of landlines in existence has remained static since 2012, but usage is falling steadily. Ofcom reported that in 2010 landline usage amounted to 129 billion minutes compared to just 74 billion minutes in 2015. In contrast, mobile usage has steadily increased from 125 to 143 billion minutes in the same period.

This still suggests a decline in verbal communication of some 37 billion minutes per annum over the period.

GRAPH SHOWING TRENDS FOR ANNUAL MOBILE AND LANDLINE PHONE USAGE



OUR THOUGHTS:

Going forward we predict a clear continuation of the same trends and a huge increase in the volume of data downloaded via mobile smartphones. By the end of 2015, there were nearly 40 million 4G connections in the UK. With the advent of 5G and the continued expansion of smartphone functionality and take-up, customers will demand TV streaming and continuous mobile high speed internet without buffering. However, the number of 4G and 5G connections will pale into insignificance compared to the virtual explosion of the Internet of Things (IoT), as each house could have five to ten things, like televisions and washing machines that connect to the internet.

If mobile connectivity is to truly succeed, then the current networks need to be substantially more robust and capable of carrying far greater volumes of traffic to ensure the desired continuity of rapid connectivity.

We predict the roll out of more 'macrocell sites' and of many more of the smaller 'microcells' and 'picocells'.



WHO'S WHO?

When the industry first began in the 1980's, operators acted independently and shared sites with some reluctance. There is a significant duopoly in the market, with two coalitions each collaborating over a jointly used network of sites, often with a single set of antennas carrying the signals for two or more operators. MBNL have been pursuing this consolidation for some eight years and CTIL for six years, however their work is far from finished.

Whilst mergers and acquisitions have already complicated the market, network convergence can create further confusion and legal issues for telecoms leases.

VODAFONE
Also own Cable and Wireless (2012).

O2
Formerly Telecom Securicor Cellular Radio, TSCR Cellnet, BT Cellnet, O2 then O2 Telefonica.

ORANGE
Formerly Hutchison Microtel then Orange PCS Ltd.

T-MOBILE
Formerly Mercury Personal Communications, 1-2-1 (or One-2-One) then T-Mobile.

HUTCHISON 3G
Trade as '3'.

CTIL (CORNERSTONE TELECOMMUNICATIONS INFRASTRUCTURE LIMITED)
Founded in September 2012, a 50/50 joint owned company set up to manage a shared network.

EE
The new name for T-Mobile who also own Orange PCS Ltd. (July 2010)

MBNL (MOBILE BROADBAND NETWORK LIMITED)
A joint venture agency to set up to merge T-Mobile and H3G sites, now incorporating Orange sites as well.

The standard mobile user still encounters six operators:



Hutchison 3G, who had joined forces with the former T-Mobile to acquire sites under joint names, were keen to acquire O2, but this has so far been blocked by the Competition and Markets Authority. BT were given consent to acquire EE. Each of these transactions cause significant potential complications to existing leasehold arrangements.

Airwave (recently acquired by Motorola) currently provide the 'blue light system' for the Emergency Services Network (ESN). However, they have been unsuccessful in re-tendering and their regional contracts will expire between 2017 and 2020.

The network will move to a 4G/LTE format operated by EE and Motorola.

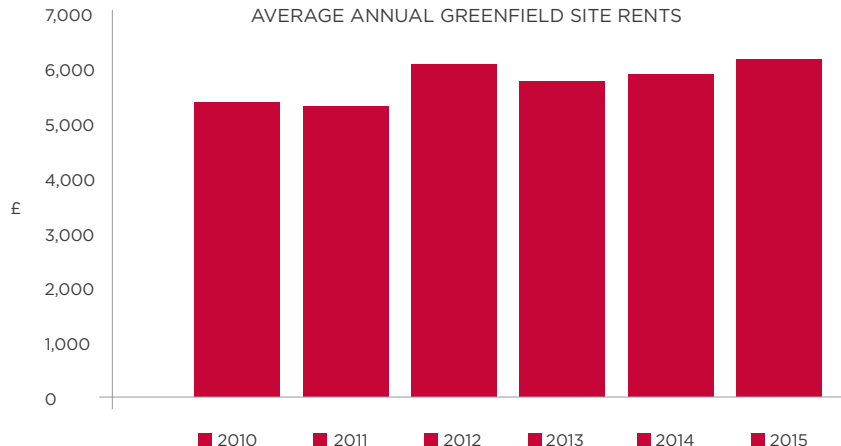
Arqiva have been the longest standing infrastructure provider in the telecoms market, having originated from the Independent Broadcasting Authority and the BBC. We anticipate that Arqiva will continue to dominate the market as infrastructure providers, particularly as the mobile operators become seemingly less interested in managing property based portfolios of sites.



GREENFIELD SITES

Contrary to operator claims that rents are in relative freefall, our statistics show a slight dip around 2010 and a steady rebound since. One explanation of this is the so-called “Rent Challenge” letters which were issued and pursued by operators, asking for rent reductions and variations to terms which favoured the operators, under a purported threat of decommissioning. Many unsuspecting or ill-advised landowners signed up without knowing whether such a threat actually existed or whether their site was already “sustainable” and required to remain within the network.

In contrast to the operators’ robust position in rent review discussions, when lobbying the Government for Code reform, they have claimed that landlords are effectively holding them to ransom and have unfettered power. We have found little evidence of ransom in the marketplace. The Mobile Operators Association (MOA) commissioned a report from Deloitte LLP which stated that the average annual rent for rural mobile masts was £7,506. Our research shows the following average rents for new leases *(most of these are in the name of the joint venture companies)*:



Average Greenfield rents currently stand at £6,029. The five year rolling average for Greenfield sites is £6,022, with many of the more rural sites well below this level. Where network convergence has taken place and two operators are sharing the same mast without an additional site share fee being payable, base rentals are generally £750 to £1,500 per annum higher than single user sites.

Some operators are, however, seeking rural Greenfield sites at rents of £3,000 with unrestricted rights.



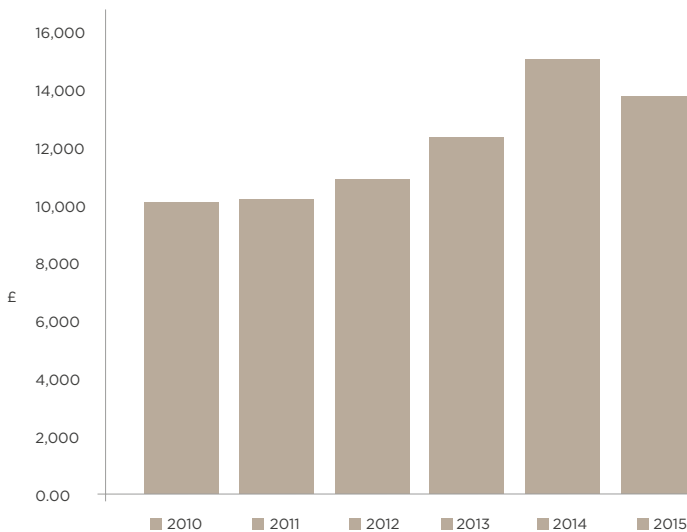
ROOFTOP INSTALLATIONS

Average rooftop rents currently stand at £13,712 per annum.

The rolling five year average is £12,607 per annum.

However, taken in isolation, the London market substantially outstrips these figures.

AVERAGE ANNUAL ROOFTOP INSTALLATION RENTS



Sharing on rooftops is generally less common, and where allowed, is usually limited to the respective network partners i.e. Vodafone/O2 and EE/H3G.

Such leases tend to be more restrictive in terms of access and sharing rights, to avoid interference with the property owner's core business. The Government's proposed new Telecoms Code (see page 13) presents considerable new challenges to the roll out of rooftop sites because of the wide rights afforded to operators, which many property owners will not want to agree to due to conflicts with redevelopments and building repairs.





LEASE TERMS

Our analysis continues to demonstrate that rents vary according to installation rights. An equipment allowance for, say, five items of equipment will generally carry a lower rent than one that allows 10 or 12 items of equipment. Operators strive for unlimited installation rights and will seek to include Mast Head Amplifiers and Remote Radio Units which substantially increase the performance of antennas and are not “ancillary”, (as one might regard mounting equipment and cable fixings to be ancillary).

Rent review patterns remain largely on a three year basis, albeit with a marginal shift towards a five year pattern. Just over 60% of leases are reviewed every three years and 37.5% are reviewed every five years. Where rents stand to be indexed linked to the Retail Price Index (RPI), a marginal increase in the market value can be achieved if the review pattern is increased from three to five years.

Operators are keen to see review mechanisms change to become Open Market Value (OMV) only. Our last survey reported 50% of review mechanisms being to the greater of OMV or RPI – this has now reduced to 36%. In 2012, 29% of reviews were to open market only and this has now increased to nearly 53%. RPI only reviews have dropped from 21% to 11%. In either instance the rent determined should not be less than the rent passing.





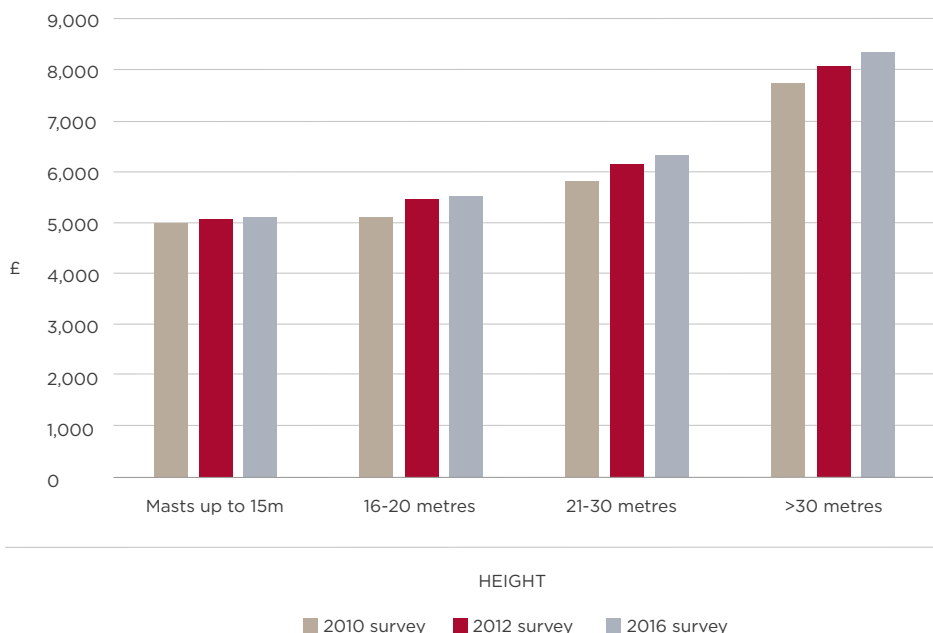
LEASE TERMS

Operators have been structuring site sharing agreements in order to minimise or avoid any site share payaway to landlords. Our last survey noted that new leases were increasingly protecting landlords against such practices in the structuring of payaway clauses. This trend has increased – there has been a shift towards restricting use or sharing to particular named operators and an increase in the number of leases which effectively prohibit further site sharing beyond specified operators or group companies. Whilst 62% of sites now include a payaway mechanism, in 2012 the figure was 68%.

The operators have had some success in seeking the free site sharing being included in the base rent and an increase of ‘all inclusive’ site share deals from 2% to 5.5% is notable; these, however, tend to be at much higher rents.

Operators still maintain that height is not a factor, but our analysis of transactions over the past five years is consistent with previous surveys and does not concur.

AVERAGE ANNUAL GREENFIELD SITE RENT BY HEIGHT





FIBRE OPTICS

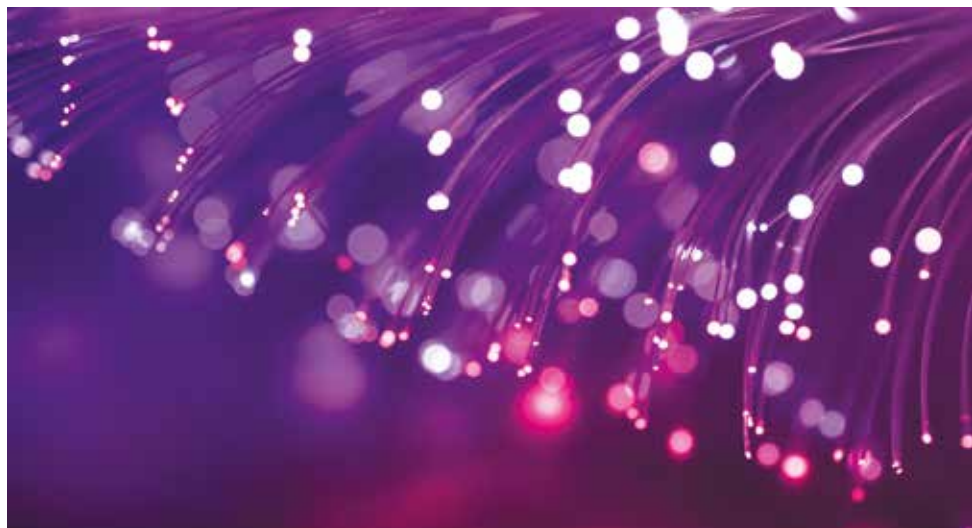
Similar consolidation has occurred in the fibre optic market.

BT owns about 86% of the fibre network in the UK. One of the first competing fibre optic networks was established by Mercury, who received one of the first licences in November 1984 to create a national network which links cities and towns.

The National Grid began installing fibre optic cables on electricity cables in about 1992, claiming it was for the purpose of operating switchgear and therefore covered by their powers under the Electricity Act 1989. In due course, they created Energis to exploit the established telecommunications network which was later sold on. Cable & Wireless acquired Energis for £594 million in November 2005 but was itself acquired by Vodafone in 2012 for £1.04 billion. This illustrates the commercial value of such networks and similar consolidation in the market.

Over the years, standardised rates have been agreed with various landowner representative bodies, but following a decision by the Office of Fair Trading, such arrangements may be deemed anti-competitive. We understand that there are no new recommended rates but operators still insist on offering a rate based on previous such agreements. In contrast, we have been agreeing deals at substantially better rates from the landowner's perspective.

Such operators put forward standard terms which are drafted in their favour again citing that these are agreed with the landowning bodies and cannot be varied.





REFORM OF THE TELECOMS CODE

The Electronic Communications Act 2003 provides compulsory powers for telecommunications operators and is often referred to as the Telecoms Code. It has been widely criticised for its lack of clarity - a leading judge described it as “the most poorly drafted piece of legislation on the statute book”.

The Government has announced drastic reforms to the Code as part of the Digital Economy Bill, which is currently being debated in Parliament. As it is currently written, the Bill will end the 200 year old practice of a property owner and operator agreeing the market rent for a site for use by an operator. Instead it favours value based on a ‘no-scheme’ world - i.e. compensation. In so doing, the Government is going against the research and subsequent recommendation of the Law Commission.

There is a vast amount of detail, but the key issue for landlords is a proposal to allow operators to assign leases, share sites and to upgrade and install additional equipment as the operator requires.

In addition, the operators will have wide access rights which could cause serious inconvenience and operational risk for landowners. As drafted at the time of going to press, the valuation of the site for rental purposes is to specifically disregard these rights. Such changes allow operators or infrastructure providers, such as Arqiva, to charge substantial site share fees and obtain profit rents at the expense of landowners.

Existing leases drafted in terms of the existing code may well be overridden by the new measures.

Whilst the current Code has earned strong criticism for being unworkable, the mobile operators have been able to successfully construct networks and the Code has seen little activity in the courts.

The Government’s changes to the Code are now so operator friendly that there is likely to be little incentive for site providers to agree terms, only for them to be overridden. The new Code is likely to be tested and disputed to a far greater extent, which is now likely to hamper the rollout of new sites rather than facilitate it as the Government had intended.

It appears likely that under the proposals, the telecoms industry will struggle to improve and maintain the current levels of coverage and the quality of the networks. ‘Not-spots’ are already being created in city centres as a result of the proposal and as potential site providers withdraw from the market.

One of the Government’s intentions had been to save the industry £1 billion over a 20 year period. With some 50,000 installations across the country, this equates to £1,000 per installation per annum. Little, if any, financial benefit will ever be noticed by the general public, so there is genuine concern that the Code reforms may merely advantage shareholders of multinational companies at the expense of site landlords, which include churches, charities, schools, local authorities and private individuals as well as Government departments and landowners who may suffer loss of revenue. As values fall, so will the business rates paid by Telecoms companies - the balance will fall on local businesses.



DECOMMISSIONING AND NEW ROLL OUT

Amongst other misinformation in the marketplace is the extent to which sites have been decommissioned. Operators would have landlords believe that “unsustainable” sites will be decommissioned without hesitation. The reality is rather different. Decommissioning generally only happens where two sites, immediately adjacent to each other, are operated by converged networks such as Vodafone and O2. Additionally, capacity problems within city centres have resulted in sites being retained in preference to decommissioning.

In terms of new rollout, there has been little activity in rural areas. The capital costs associated with constructing a site in a non-commercial area is a key concern for operators and a more compelling reason not to rollout sites. There is no hard evidence that landlords and rent are the cause of the problem for network coverage.

The current Telecoms Code includes obligations on operators to remove redundant equipment. The new Code lacks the same provisions, so landowners will need to agree contractually that masts and equipment are removed upon the service of a break notice or upon expiry of the lease.





About us

As never before the Telecoms market remains the realm of the true specialist.

Based in both the Shrewsbury and Banchory offices, Strutt & Parker has a dedicated resource who have in excess of 80 years' combined experience in the telecoms industry. The team is comprised of eight individuals who advise solely on telecommunications leases. This enables us to offer advice tailored to the needs of our clients based on a full knowledge and understanding of the marketplace and to maximise the opportunities that the industry continues to offer, whilst avoiding the pitfalls.

Our wide and comprehensive understanding of the industry enables us to advise on every aspect of the market across the UK.

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RENT REVIEWS

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SITE SHARING AND MARKETING

MULTI-SITE AGREEMENTS

MANAGEMENT

SALES AND ACQUISITIONS

UPGRADES AND RENEGOTIATIONS

EXPERT VALUATION EVIDENCE

DECOMMISSIONING

ALTERNATIVE USES

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