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Generating Revenue from Real Estate Telecom Agreements

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Only last year, commercial office owners were routinely entering into agreements with telecom providers to not only bring essential communication services to their buildings, but also to generate ancillary income through license fees and other "revenue share" arrangements. Last year now feels like the very distant past.

Dramatic changes have occurred over the last twelve months in the real estate technology sector. As the economy has slowed and the shakeout of the communications industry has progressed, numerous telecom companies focusing on the real estate industry have failed, including Broadband Office, OnSite Access, Darwin Networks, Teligent, Windstar and Allied Riser.

Others providers, taking advantage of existing market conditions, have gone on a buying spree: Cogent, has acquired Allied Riser and the assets of the bankrupt Netrail. eLink Communications has received court approval to acquire assets of bankrupt OnSite Access. Yipes Communications has received court approval to acquire rights formerly owned by bankrupt Broad Broadband Office.

Incumbent providers, such as Verizon and Qwest Communications, and cable franchisees, such as Cox Communications and Time Warner, continue not only to survive, but also to gain increased market share due to the absence of meaningful competition from the weakened private carrier sector. Fewer reliable communications providers exist to service real estate owners and their constituent tenants. As a result, opportunities for owners to generate ancillary revenue from telecom agreements are becoming increasingly limited.

At the same time that dependable provider choices are diminishing, sophisticated commercial office tenants are increasingly demanding a higher quality of building with state of the art telecom services and capabilities for the bandwidth driven applications and technologies they continue to integrate into their core business operations.

In this dynamic and changing market, building owners must concentrate on ways to ensure that their assets remain competitive and marketable. They must approach the selection of telecommunications providers with the same attention and due diligence that they bring to the acquisition of real estate assets for their portfolios. Owners must also integrate into their buildings alternative and redundant telecom services so that their tenants can feel confident about the stability and continuity of these indispensable communication tools.

Given the need to focus on these principal business objectives, as well as the absence of meaningful provider competition and the grim market conditions, is it still possible for building owners to also achieve an ancillary goal of generating revenue from their telecom relationships?

Revenue Generation from Telecom Agreements is Still Feasible in this Market.

Opportunities continue to exist in this market to generate ancillary telecom revenues from commercial office buildings through marketing and license fees, equipment room rentals,

rooftop access fees and termination payments. However, the availability of these revenue sources depends significantly on a number of factors: Are there competitive, as well as incumbent local exchange carriers servicing the area in which the buildings are located? Are the buildings in a key location that is essential for the carriers to complete their network or expand their portfolios? How many buildings are in the owner's portfolio? What is the size and tenant mix in each building for which the owner is seeking revenue arrangements?

Marketing Fees

Marketing fees are essentially "revenue shares arrangements" where a provider pays to the owner a specified percentage of the provider's gross collected revenues from the building in exchange for the owner's agreement to perform minor marketing activities for the provider.

A recent FCC building access order prohibits telecom providers from entering into exclusive contracts with owners for servicing their commercial buildings. This prohibition hits at the heart of the revenue share model. Without exclusivity and the associated assurances that a provider will be the only choice in the building, it is difficult for the provider to achieve the tenant penetrations it requires to render its capital investment in the building profitable. Consequently, providers have much less incentive to share their revenues with building owners. The absence of meaningful telecom competition in many markets only makes this situation worse for building owners.

Nevertheless, since the FCC order does not ban exclusive marketing contracts, owners can agree to exclusively market and promote only one provider, even if the owner is required to offer building access rights to others. Depending on the size and location of the building, the number and type of building tenants and whether the provider is an incumbent or competitive local exchange carrier, owners can often achieve marketing fees in exchange for these marketing activities in the range of ten percent of gross collected revenues. Often, payment of these fees will only begin after the provider hits a minimum penetration level in the building. If the owner has significant negotiating power, the percentage of the marketing fee may escalate as the provider's tenant penetration levels in the building increase.

License Fees

In order to supply their services, providers often require the use of secure space in the building to house their equipment. Owners can generate revenue by requiring providers to pay "rent" for this space in the form of a license fee. License fees are often structured similarly to rent, based upon the amount of square footage required by the providers and the prevailing rental rate for tenant occupied building space (even if the provider's space is located in the basement, garage or rooftop of the buildings).

If a provider requires a license or easement to run its cabling or fiber across an owner's property, an owner can charge the provider a license fee in exchange for such access rights. These fees vary from property to property, depending upon the location of the property and how essential the project is to the provider's network. The closer the property is to a "tier one" expensive urban area, the higher the access fee the owner can impose.

Equipment room and cabling license fees can be paid annually, quarterly or monthly. Generally, these fees escalate annually anywhere from three to five percent. An owner can sometimes successfully negotiate that the fees reset to a market rate (with a floor of the

current fee then in effect) at the beginning of each renewal term under the applicable agreement.

Rooftop Rights

One of the easiest ways for an owner to generate ancillary revenue is to identify carriers that require the use of the owner's building rooftop to install antennae and house other equipment in order to complete or expand the carriers' communications networks. In exchange for these "rooftop rights," carriers will generally pay license fees for the antennae, as well as for the related equipment room they require. Rooftop license fees vary from market to market. They are typically determined based upon the number of antennae to be installed or adjacent to the rooftop and tend to be in the range of $500 to $1,500 per month, depending on the number, size and visibility of the antennae from the rooftop. As with the equipment room and cabling license fees, these rooftop fees also escalate annually from three to five percent and can sometimes reset to market at the beginning of each renewal term. If the carrier reserves the right in the agreement to install additional antennae at a later point during the term, the owner should impose a supplemental license fee for the additional antennae.

Termination Fees

Providers often reserve a right to terminate their agreements with owners before the expiration of the term and at any time that it becomes "uneconomic" for the provider to offer service to the building or utilize the antennae or other equipment located at the property. In exchange for this exit strategy, Owners can impose a termination fee. Most often, termination fees are in the form of liquidated payments the provider must pay at the time it issues the required agreement termination notice. They are typically in the range of six months of the license fee or other revenue payment then in effect under the agreement.

To ensure that buildings stay competitive, owners must make available for their tenants a variety of reliable telecom services. While pursuing this objective, owners should not overlook the opportunities that still exist in this market to generate ancillary revenue through these essential telecom agreements. One of the biggest challenges to achieving both of these goals revolves around the absence of meaningful competition in the telecom sector. As building owners look to the future, they should consider supporting initiatives that will foster telecom competition and meaningful provider choices for their buildings and their tenants.

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