

Clients & Friends Memo

Potential Impact of New SEC Rules on Cell Tower Securitizations

September 30, 2014

On August 27, 2014, the Securities and Exchange Commission (the “SEC”) adopted two final rules implementing new regulations affecting asset-backed securities (“ABS”). The first set of rules, referred to in this memorandum as the “Third Party Reports Rules,”¹ include new rules requiring the filing of the findings and conclusions of reports of third-parties who have been employed by issuers and underwriters to provide due diligence services. The second set of rules, referred to in this memorandum by its popular name, “Regulation AB II,”² relate to asset-level disclosure and shelf registration requirements applicable to ABS transactions. These rules impose significant new filing, reporting and disclosure obligations on parties to ABS transactions. This memorandum discusses the applicability of these final rules to cell tower securitizations.

Background—Cell Tower Securitization Structures

We are aware of two different securitization structures currently in use by cell tower companies to securitize rental revenues received from tenant leases on cell towers that they own or operate.

Loan Agreement Structure

In one type of cell tower securitization, referred to in this memorandum as a “Loan Agreement Structure”³, the cell tower company transfers its ownership interests in numerous cell towers

¹ For the text of the SEC’s adopting release for the Third-Party Reports Rules, see <http://www.sec.gov/rules/final/2014/34-72936.pdf>. The Third-Party Reports Rules were the subject of a Cadwalader, Wickersham & Taft LLP Clients & Friends memorandum, dated September 9, 2014, “New Rules for Third-Party Due Diligence Reports for Asset-Backed Securities,” available at <http://www.cadwalader.com/resources/clients-friends-memos/new-rules-for-third-party-due-diligence-reports-for-asset-backed-securities>, which describes the requirements of the Third Party Reports Rules.

² For the text of the SEC’s adopting release for Regulation AB II, see <http://www.sec.gov/rules/final/2014/33-9638.pdf>. Regulation AB II was the subject of a Cadwalader, Wickersham & Taft LLP Clients & Friends memorandum, dated September 5, 2014, “At Long Last—SEC Adopts Final Regulation AB II,” (the “Regulation AB II Memo”), available at <http://www.cadwalader.com/resources/clients-friends-memos/at-long-last---final-regulation-ab-ii>, which describes the requirements of Regulation AB II.

³ Examples of cell tower securitization transactions using the Loan Agreement Structure include SBA Tower Trust, Secured Tower Revenue Securities, Series 2013-1 and Series 2013-2, and American Tower Trust I, Secured Tower Revenue Securities, Series 2013-1 and Series 2013-2.

(including its rights to rental payments under the related telephony tenant leases) to one or more special purpose entities. These special purpose entities enter into a mortgage loan agreement (the “Loan Agreement”) with the securitization depositor as the lender and the special purpose entities as borrowers under a series of notes which typically have staggered maturities. The depositor assigns its interest as lender in the Loan Agreement and notes to a trust. The trust issues pass-through certificates, each class of which represents an individual ownership interest in a class of notes. The pass-through certificates are offered and sold in a Rule 144A transaction. The trustee of the trust has the right to exercise all rights of the lender under the Loan Agreement. The tenants make lease payments to the borrowers under the Loan Agreement. A servicer collects these payments and pays the trustee amounts distributable as principal and interest on the pass-through certificates.

Loan Agreement Structures typically include (i) title insurance policies, assuring the borrowers have rights to the cell tower sites, and (ii) payment guaranties on the borrower’s obligations under the Loan Agreement by the parent of the borrowers. The guarantors pledge the equity interests in the borrowers as security for their guarantee obligations. In addition, affiliates of the cell tower company typically enter into a management agreement pursuant to which they manage and operate the cell towers.

Indenture Structure

In another type of cell tower securitization, referred to in this memorandum as an “**Indenture Structure**”⁴, the cell tower company similarly transfers its ownership interests in numerous cell towers and related telephony leases to one or more special purpose entities. These special purpose entities enter into an indenture (the “**Indenture**”) with an indenture trustee, and issue notes, that are offered and sold in a Rule 144A transaction. The indenture trustee collects the tenant’s lease payments and pays investors principal and interest on the notes. Indenture Structures do not include mortgages on the individual tower sites.

Indenture Structures include payment guaranties by the parent of the issuers on the issuer’s obligations under the Indenture. The guarantor pledges the equity interests in the borrowers as security for the guarantee. In addition, affiliates of the cell tower company typically enter into a management agreement pursuant to which they manage and operate the cell towers.

⁴ An example of a cell tower securitization transaction using the Indenture Structure is Crown Castle Towers LLC, Senior Secured Tower Revenue Notes, Series 2010-4.

Definition of “Asset-Backed Securities”⁵ For the Purposes of the Third Party Reports Rules

The Third Party Reports Rules apply only to ABS, as defined in Section 3(a)(79) of the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”). The Exchange Act defines ABS as “a fixed income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to **receive payments that depend primarily on cash flow from the asset** (emphasis added)”⁶ While not entirely clear from the final rules or the related SEC commentary and proposed rules⁷, whether cell tower securitizations are ABS subject to the Third Party Reports Rules or not may depend upon the securitization structure utilized. If that is the case, the final rules could impose additional burdens on cell tower companies using the Loan Agreement Structure as opposed to the Indenture Structure.

In cell tower securitizations utilizing a Loan Agreement Structure, the pass-through certificates could be classified as fixed income securities, collateralized by a self-liquidating asset (*i.e.*, the underlying notes, which provides for regular payments of principal and interest, and has a stated maturity date). In the Loan Agreement Structure, payments on the pass-through certificates depend primarily on cash flow from the underlying notes. As a result, the Loan Agreement Structure may be viewed as similar to the structure utilized in mortgage loan securitizations, which the SEC considers to be ABS.

⁵ The portions of the final rules analyzed in this memorandum apply to “asset-backed securities” within the meaning of Section 3(a)(79) of the Exchange Act, as opposed to the more limited definition of that term in Item 1101(c) of Regulation AB.

⁶ The definition of ABS in the Exchange Act is more expansive than similar defined terms in the Securities Act of 1933, as amended (the “**Securities Act**”). For example, Item 1101(c) of Regulation AB under the Securities Act defined asset-backed securities to be “a security that is primarily serviced by the cash flows from a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any right or other assets designed to assure the servicing or timely distributions of proceeds to the security holders; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases.”

⁷ Asset Backed Securities, SEC Release Nos. 33-9177, 34-61858, available at <http://www.sec.gov/rules/proposed/2011/33-9177.pdf>.

Cell tower securitizations utilizing an Indenture Structure should not fit within the Exchange Act definition of ABS because payments on the notes do not “depend primarily on cash flow from the assets.” The SEC has adopted a “residual value” test to determine if payment on securities depend “primarily” on cash flow from the assets.⁸ Under the residual value test, in order to qualify as ABS:

... the portion of the cash flow to repay the securities anticipated to come from the residual value of the physical property underlying the leases could not constitute . . . 50% or more, as measured by dollar volume, of the original asset pool at the time of issuance of the asset-backed securities.⁹

The SEC’s stated rationale for the residual value test is that if that if the residual value of the underlying assets exceed the stated threshold percentage, the transaction is not simply dependent upon the servicing and amortization of the pool assets.¹⁰ Rather, the performance of the securities will depend upon the final disposition of the assets at conversion or realization. If the residual value of the underlying assets is high relative to the cash flows they generate, then related securities do not resemble typical ABS, and thus should not be subject to the same regulatory scheme as traditional ABS that have a greater dependence upon cash flows.¹¹

Assuming that the residual value test adopted by the SEC with respect to the Regulation AB definition of ABS applies to the Exchange Act definition of ABS, cell tower securitizations with Indenture Structures would typically satisfy the residual value test because, at the time of issuance, more than 50% of the cash flow to repay the securities is anticipated to come from the residual value of the cell towers. Thus, the notes should not be considered ABS for the purposes of the Third-Party Reports Rules. The notes are similar to secured debt of an operating company, or a loan to a borrower secured by an interest in real property. Those transactions are not ABS.

Arguably the same results should apply to the Loan Agreement Structure because the pass-through certificates merely represent ownership of the underlying notes. However, the transaction structure could affect the application of the Third Party Reports Rules.

⁸ The SEC adopted the residual value test with respect to the Regulation AB definition of ABS, but the rationale would seem to apply to the Exchange Act definition of ABS as well.

⁹ 70 Fed. Reg. at 1519.

¹⁰ 70 Fed. Reg. at 1519.

¹¹ 70 Fed. Reg. at 1519.

The “Catch All” In the ABS Definition

We note that the Exchange Act definition of ABS includes a “catch-all” provision: “[a] security that the [SEC], by rule, determines to be an asset-backed security for purposes of this section.”¹² Thus, there is a possibility that the SEC might enact a rule which would result in cell tower securities being subject to the Third Party Reports Rules and Regulation AB II.

Given the lack of specific discussion of cell tower securitizations in the SEC commentary and releases relating to the Third Party Reports Rules and Regulation AB II, interpretive uncertainties about the applicability of the residual value test to cell tower securitizations, and the ability of the SEC to avail itself of the “catch all” provision, it is uncertain if cell tower securitizations are subject to the Third Party Reports Rules and Regulations AB II, and whether the applicability of the final rules depends upon the securitization structure used. The applicability of the Third Party Reports Rules and Regulations AB II to cell tower securitizations may be an appropriate topic for a “no action” request letter to the SEC.¹³

Applicability of Regulation AB II

As originally proposed, Regulation AB II would have applied to public offerings and Rule 144A ABS transactions.¹⁴ As finally adopted, Regulation AB II applies only to public offerings. Cell tower securitizations have not been done as public offerings. For the moment, it appears that the burdensome disclosure and shelf-registration requirements of Regulation AB II will not apply to future cell tower securitizations, so long as they are done as private placements or Rule 144A transactions. However, the SEC has expressed concerns that if ABS securitizations migrate to private deals in an effort to escape the requirements of Regulation AB II, at some point in the future, the SEC might change its position and require similar disclosures and issuance requirements for private placements. If that happens, the definition of ABS as it applies to cell tower securities will become relevant to the Regulation AB II analysis, and to the extent cell tower securitizations are ABS transactions for the purposes of Regulation AB II, they will be subject to the disclosure requirements of Regulations AB II. We will continue to monitor these developments.

¹² Exchange Act, Section 3(a)(79)(vi).

¹³ A “no action” request, is a request by a person that the SEC to confirm that, if the person enters into a transaction as described in their request, the SEC would not recommend that the SEC take enforcement action against such person based on the facts and representations set forth in such person’s request. In this case, the request would be to confirm that cell tower securitizations are not ABS for the purposes of the Third Party Reports Rules or Regulations AB II.

¹⁴ The original proposing release for Regulation AB II was Release Nos. 33-9117, 34-61858, 75 Fed. Reg. 23328 (May 3, 2010), available at <https://www.sec.gov/rules/proposed/2010/33-9117fr.pdf>, which was subsequently re-proposed, with modifications, as Release Nos. 33-9244, 34-64968, 76 Fed. Reg. 46948, Aug. 5, 2011), available at <https://www.sec.gov/rules/proposed/2011/33-9244fr.pdf>.

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Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

Malcolm P. Wattman	+1 212 504 6222	malcolm.wattman@cwt.com
Michael A. McCormack	+1 212 504 6569	michael.mccormack@cwt.com
Michael S. Gambro	+1 212 504 6825	michael.gambro@cwt.com
Stuart N. Goldstein	+1 704 348 5258	stuart.goldstein@cwt.com
Frank Polverino	+1 212 504 6820	frank.polverino@cwt.com