

This Month in New Economy Real Estate: Cell Phone Towers & Data Centers

Published October 12, 2022

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WisdomTree has a platform of different thematic investing strategies, and really any thematic strategy has its own infrastructure requirements. Information technology megatrends—think cloud computing, 5G connectivity, the internet of things or even artificial intelligence—may seem like they don't need infrastructure in the same way as megatrends involved in making more physical things, but they do.

A lot of these megatrends could not function to the same degree that we are used to without cell phone towers and data centers.

New Economy Real Estate vs. Old Economy Real Estate

This year has been defined by the macroeconomic landscape, and inflation is at the top of that list of defining factors. During a high inflation environment, real estate is an interesting asset class. First of all, we've seen how the markets have emphasized cash flows over the concept of possible future profits. Many types of real estate investments are known for their capability to generate cash flows. Secondly, there is the fact that, in typical inflationary environments, one should focus more on real assets—assets where the value should increase at least in line with inflation. The value of real estate has been known to do this over time, even if we could never guarantee it always would in the future.

But if we peel the layers back—after the Covid-19 pandemic, are we as excited by strip malls and old-style office buildings as we once were?

In our view, 'New Economy' real estate is defined by the physical infrastructure that needs to exist in order for different megatrends that people already believe in to continue to scale up. Two of the most important focal points of megatrend infrastructure are:

- Cell phone towers
- Data centers

Cell Phone Towers

When considering cell phone tower real estate in 2022, the primary attributes are incredible visibility into business cash flows and also very little economic variability. These companies tend to deal in very long-dated contracts. They also tend to operate in the investment-grade end of the credit spectrum.¹

If we think beyond the difficulties of the current macroeconomic picture, we can see that we are in the earlier parts of the global 5G deployment. Over the years, we have seen 2G, 3G, 4G...and now we are seeing

5G. The primary activities to upgrade global networks began in 2021, and while we can't know for sure how long the upgrade cycle will take, it could be somewhere in the range of 5 to 7 years as a reasonable prediction. There tend to be both software and hardware-oriented elements with these upgrades.²

The business model of cell phone towers is fairly simple, in that the entities that want to use the hardware—like telecommunications companies—will pay regular fees to do so. If we think of 'data as the new oil,' it's similar to how energy producers pay the pipeline companies to use the infrastructure. It's interesting to consider the difference between U.S. and non-U.S. companies with respect to how they tend to deal with inflation:

- U.S. companies have tended to sign deals with longer, multi-year terms and 3% annual, fixed escalators. In past years, this was excellent. In years when inflation is at or near double-digit levels, of course, it is less ideal.³
- Non-U.S. companies tend to see deals where there are uncapped escalators that are indexed to various measures of consumer price inflation.⁴

Another point—investors may be curious about the difference between focusing more directly on the companies that, for instance, provide the 5G services, as opposed to the companies that provide the infrastructure that allows for the data to be transferred more efficiently. We note that, for telecommunications companies in particular, the rates that they can charge consumers are highly regulated. These companies are also forced to make huge capital expenditures to be able to say they can at least match the best network capabilities. Cell phone towers may not have the same visibility, but we return to our original note about the visibility and limited variability of cash flows. Remember—it's more about the fact that the pipes are needed than exactly what is flowing through them.

Data Centers

If readers take away one point about data centers from this piece it should be that they are all about scale. If one is thinking about Equinix and Digital Realty Trust today, it should be to recognize that these are unrivalled global platforms. Operating a new data center today at low scale would be a horrible business. Equinix data centers, spread across many of the world's countries, function as the backbone of the internet, in a way.

Some might wonder why the world's largest companies, like Microsoft, Amazon and Alphabet, can't just build their own data centers? Why do they need to pay Equinix or Digital Realty Trust? We can agree that the negotiating power of data center providers against these companies has not been high historically, but in 2022 it has been interesting that a few things are changing.

- Internet traffic has been increasing
- The supply of the right types of semiconductors to use in data centers has continued to be tight
- It is not necessarily a simple matter to increase the capacity of existing data centers or to build new data centers in the right locations, at least not with enough speed to match demand

If one thinks of the supply of data centers like the supply of say, commodities, then if the supply is tightening and the demand is stable to increasing, then the price should tend to increase. It's possible that we will see some of the biggest growth in pricing power of data centers in 2022 than we've seen in recent history.⁵

We also note an interesting practice that we have seen from Equinix, again, one of the largest players in the space. Equinix actually hedges roughly two years of its forecasted energy demand. This means that customers will not have to pay the full cost of energy price increases. At a time when energy prices have risen significantly, this is a very interesting policy to consider.⁶

Conclusion: Real Estate Could Have a Place within a Thematic Strategy

Thematic equities are frequently equated with 'growth equities,' and this is done with good reason. However, for those thematic investors that might, for example, prefer to see 'cash flow generation' as a primary attribute, New Economy real estate is an interesting consideration. A data center real estate investment trust (REIT) will exhibit an income statement with a totally different look and feel than a Software-as-a-Service (SaaS) cloud company. Maybe in 2022's macro environment the correlation between these two is a bit higher, but once the fundamentals of the underlying businesses are able to come back to the fore, we think the two should exhibit significant differences in risk and return.

Investors looking to allocate to a strategy that would typically have significant exposure to cell phone towers and data centers may want to take a deeper look at the [WisdomTree New Economy Real Estate Fund \(WTRE\)](#).

1 Source: hojacapital.com/cell-tower-reits

2 Source: statista.com/chart/23194/5g-networks-deployment-world-map/

3 Source: dgtinfra.com/cell-tower-lease-rates-agreements

4 Source: dgtinfra.com/cell-tower-lease-rates-agreements

5 Source: Carol Ryan, "Data Centers Are Unpopular. All the Better for Their Stocks," *Wall Street Journal*, 8/30/22.

6 Source: Maurer et al., "Hedges Give Companies Temporary Relief from Surging Energy Prices," *Wall Street Journal*, 3/14/22.

Christopher Gannatti is an employee of WisdomTree UK Limited, a European subsidiary of WisdomTree Asset Management, Inc.'s parent company, WisdomTree Investments, Inc.

As of October 5, 2022, WTRE held 0%, 3.35%, 0%, 0%, 0% in Equinix, Digital Realty Trust, Microsoft, Amazon and Alphabet, respectively. Click [here](#) for a full list of Fund holdings.

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