

STAFF PAPER

December 2014

IASB Meeting

Project	Matters arising from the IFRS Interpretation Committee		
Paper topic	IAS 40 <i>Investment Property</i> : Accounting for a structure that appears to lack the physical characteristics of a building		
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Objective of this meeting

1. The purpose of this meeting is for the International Accounting Standards Board (IASB) to:
 - (a) discuss the feedback received in the outreach performed by the staff and the staff analysis, and
 - (b) decide what future action should be taken to address the issue of whether the scope of IAS 40 *Investment Property* should be broadened to include assets other than land and buildings.

Structure of this paper

2. This agenda paper is set out as follows:
 - (a) Background
 - (b) Details of the outreach performed
 - (c) Staff analysis
 - (d) Staff recommendation and question for the IASB
 - (e) Appendix: Detailed summary of feedback received during the outreach

Background

3. At its July 2014 meeting, the IASB considered an issue that had previously been discussed by the IFRS Interpretations Committee. The issue was whether an entity should apply IAS 40 *Investment Property* to account for a structure that lacks the physical characteristics of a building, such as a telecommunication ('telecom') tower, if the structure would otherwise meet the criteria to be accounted for as investment property in accordance with IAS 40.
4. The Interpretations Committee noted that towers held by tower companies (ie companies, that are not telecom companies, whose primary business is to own towers and rent space on those towers to telecom companies) have some of the characteristics of investment property. However, the Interpretations Committee expressed concern as follows:
 - (a) it is questionable whether the tower qualifies as a 'building' because it lacks the features usually associated with a building, such as walls, floors and a roof; and
 - (b) the same question could arise about other structures, such as gas storage tanks and advertising billboards.
5. The Interpretations Committee expressed general support for broadening the scope of IAS 40 to also include a structure that lacks the physical characteristics associated with a building, such as a tower, but to do so by focusing on the way the asset is used rather than by focusing on the physical characteristics of the structure or on whether it is fixed to land.
6. The IASB generally shared the Interpretations Committee's views and concerns and directed the staff to undertake preliminary research on this issue to help the IASB to decide how to proceed.

Details of the outreach performed

Participants

7. The staff performed outreach with:

- (a) four telecom companies and five tower companies to discuss the different market practice of tower leasing around the world—to understand whether the business models of tower companies are similar to those of entities holding investment property and how widespread those business models are.
- (b) two investor relations departments of tower companies and five analysts that follow tower companies— to understand what kind of information investors and analysts are looking for when investing in tower companies and whether they would prefer towers to be accounted for as investment property.

Key points from the outreach

- 8. A detailed summary of the feedback received during the outreach is provided in the appendix to this agenda paper. In paragraphs 9-14 the staff have highlighted the key points from the outreach that they think are likely to be most relevant to the IASB discussion today.
- 9. The staff note that in some jurisdictions, for example Indonesia and the US, the business model of the tower companies is very similar to investment property held for rental purposes, such as office buildings and shopping malls, in that:
 - (a) the towers are held for rental purposes and an individual tower generates cash flows from rental revenue independently from other towers; and
 - (b) the ongoing services provided by the tower companies consists only of maintenance of the tower and the shelter beneath, excluding the telecom company's equipment.
- 10. Nevertheless the staff note that in other jurisdictions, eg parts of Africa and India, the ongoing services are more significant to business model of the tower companies. These services can include security, supply of power via a special generator, and installation and maintenance of the telecom company's equipment.
- 11. The rental of towers to telecom companies by tower companies appears to be an emerging business model. During outreach the staff received feedback about a number

of transactions where telecom companies have sold their tower portfolios to tower companies and then leased space back on those towers in order to free up capital, reduce costs and risks, and focus on their core business.

12. The staff have identified the following differences between towers and traditional real estate that may be worth considering:
 - (a) Towers are generally not bought and sold on an individual basis in the market. Where sale transactions have taken place, they have been sales of portfolios of towers or acquisition/mergers of companies owning tower portfolios.
 - (b) Tower companies intend to hold the towers until the end of their economic life, meaning the tower is held for rental purposes only and not capital appreciation.
 - (c) Tower companies usually lease the plot of land under the tower, rather than own it. Land leases are entered into with a number of different third parties.
 - (d) The location of the tower is specified in the lease agreement between the tower company and the telecom company. However it appears that in many cases an exact spot/area on the tower is not specified in that lease agreement, only an approximate height on the tower.
 - (e) A tower company generally supplies its tenants with several towers in many different locations, rather than a single site.

13. Feedback from analysts in our outreach indicated that most analysts primarily focus on the cash flows generated by towers and the models they use to value companies reflect this. However, there were generally mixed views between participants (including analysts and investor relations departments of tower companies) on whether investors and analysts would prefer tower companies to have the option to account for towers at fair value through profit or loss and whether fair value information is useful (fair value information is required even if a cost model is applied under IAS 40). Many of the participants expressed concern that fair value measurements of towers [could be] are very subjective because they are based on management's judgement, and hence [would] have limited use.

14. During outreach the staff has received feedback that a similar business model to that of tower companies (in the sense that a company rents out space on the assets to tenants) may exist in other sectors, eg companies holding advertising billboards and storage locations, and is likely to appear in other industries such as companies with oil pipelines, fibre optic networks, pylons, solar farms, wind farms etc. There also seems to be an emerging practice in the US of entities owning these types of assets divesting those parts of their business to achieve REIT status. Consequently, the staff think the issue of applying IAS 40 to structures other than land and buildings may arise in other industry sectors in the future.

Staff analysis

15. The staff analysis is set out as follows:
- (a) What is the current objective of IAS 40?
 - (b) Is the limitation that investment property must be land and/or buildings appropriate?
 - (c) If the IASB relaxes the limitation how far should it be relaxed?
 - (d) Additional staff observations on relaxing the limitation
 - (e) Suggestions for further outreach

What is the current objective of IAS 40?

16. *Investment property* is defined as property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:
- (a) use in the production or supply of goods or services or for administrative purposes; or
 - (b) sale in the ordinary course of business.
- (IAS 40.5)

17. A separate Standard was developed for investment property because the IASC Board determined that:
- (a) the characteristics of investment property differ sufficiently from the characteristics of owner occupied property; and
 - (b) that information about the fair value of investment property, and changes in that fair value, is highly relevant to users of financial statements.
- (IAS 40.B6).
18. IAS 40.7 notes that “Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property.” Based on reading IAS 40 and considering IAS 40.7, the staff think that the main focus of IAS 40 is on the characteristic that investment property generates cash flows largely independently of other assets through rental and/or capital appreciation.
19. The staff do not think it is clear in the Basis for Conclusions accompanying IAS 40 why the IASC Board restricted the scope of IAS 40 to land and buildings. The staff presume it may be because at the time IAS 40 was issued the need for fair value information for non-financial assets had only arisen in the context of traditional real estate, and not for other types of non-financial assets held as relatively passive investments for rental or capital appreciation purposes. Plus in the latter case, such business models may have been rare in practice.
20. Nevertheless, based on the staff outreach it appears to be an emerging trend that companies are holding other types of assets that have similar cash flow characteristics and are used in similar business model to investment property held for rental purposes (see paragraph 14).
21. Consequently, in light of these emerging practices, the staff think the IASB should consider:
- (a) Whether the limitation in IAS 40 that investment property must be land and/or buildings is appropriate?
 - (b) If the IASB decides to relax this limitation, how far should it be relaxed?

Is the limitation that investment property must be land/buildings appropriate?

22. Based on our analysis, the staff have identified the following possible advantages of retaining the current limitation to land and buildings (assuming a strict reading of the definition of a building – eg must have walls and a roof):

- (a) In many jurisdictions the real estate market is active and there are frequent transactions of individual items of real estate. Based on our outreach, this is not the case for telecom towers, and also appears not to be the case for other assets held for rental purposes, eg advertising billboards etc. These assets are usually intended to be held by an entity for its economic life. Furthermore, if they are sold this appears to usually be a portfolio basis or through an acquisition of the company holding the assets. Without frequent comparable market transactions, the methods used to estimate fair value, eg discounted cash flow calculations, may be more time consuming and subjective. This is particularly likely to be the case where assets are subject to short term lease agreements, eg rental of space on advertising billboards.
- (b) Real estate is usually held for capital appreciation as well as to earn rental income. Other structures such as telecom towers, advertising billboards etc are usually intended to be held for the whole of their economic life for rental purposes. Some interested parties think that fair value accounting is better suited for investments that are held for capital appreciation and are expected to be sold in the future, than for assets that are only held for rental purposes.
- (c) The staff of the IFRS Interpretation Committee performed outreach to large accounting firms and the International Forum of Accounting Standard Setters (IFASS) and feedback did not indicate there was demand outside Indonesia to increase the scope of IAS 40 for telecom towers and other structures in paragraph 14. Furthermore outside Indonesia there appears to be no diversity in accounting for these other structures. These structures appear to all be classified as PPE in IAS 16 because the structures do not meet the definition of a building or/and because the ancillary services provided to tenants are significant to the arrangement.

- (d) If additional assets are included in IAS 40, it might result in fewer entities measuring their investment property under the fair value model. This is assuming the IASB retains the requirement that one accounting policy must be applied to all investment property in IAS 40. For example some entities/ investors may not think that recognising changes in fair value is helpful in assessing the performance of the company, particularly if fair value measurements are subjective.

23. The staff have identified the following possible disadvantages of retaining the current limitation to land or/and buildings:

- (a) Limiting the scope to land or/and buildings appears to have no clear basis and could be described as a rule rather than a principle.
- (b) In the IASC Board's view, the fair value model provides useful information about property held for rental, even if there is no immediate intention to sell the property. The fair value of an investment property can be regarded as a market-based representation of the value of the future net rental income, regardless of whether the entity is likely to sell the property in the near future (IAS40.B36). This reasoning seems equally applicable to other non-financial assets held for rental purposes. The cash flow characteristics of telecom towers are very similar to buildings such as storage warehouses, office buildings, shopping centres.
- (c) In many jurisdictions the real estate market in some locations is not active. However fair value information is still required by IAS 40 unless there is clear evidence when an entity first acquires an investment property that the fair value of the investment property is not reliably measurable on a continuing basis. It is noted this would only arise in exceptional cases (IAS 40.48). The fact that the IASC Board requires fair value information, except in exceptional cases, for investment property even when the market is not active undermines the argument in paragraph 22(a) above.
- (d) In IAS 40.B34 the IASC Board noted that it thinks that property used for similar purposes should be subject to the same accounting treatment. This

rationale would support extending IAS 40 to other non-financial assets used for similar purpose, rather than focussing on their physical characteristics.

- (e) The Interpretations Committee expressed general support for broadening the scope of IAS 40 (see paragraph 5).
- (f) Whilst this issue has currently only arisen in one industry/one jurisdiction, namely tower companies in Indonesia, it appears that holding assets other than land and buildings in a business model like investment property is an emerging practice in a number of other industries (see paragraph 14) and so this issue has the potential to spread. It may be appropriate for the IASB to address this issue before it becomes more widespread.

If the IASB decides to relax the limitation, how far should it be relaxed?

Four options

- 24. The staff have identified four options:
 - (a) Option 1 – Keep the existing limitation for investment property to be land or a building—or part of a building—or both.
 - (b) Option 2 – Relax limitation to include other structures fixed to land or buildings on a permanent basis.
 - (c) Option 3 – Relax limitation to include all non-financial assets where location is the primary consideration, ie where the future cash flows to be earned from the structure depend primarily upon its location.
 - (d) Option 4 – Relax limitation to include all non-financial assets.
- 25. Note: These options only consider revising the limitation that investment property must be ‘land or a building—or part of a building—or both’. Consequently under Options 1-4 the assets would also be required to meet the other requirements to be investment property in IAS 40. Furthermore Options 1-4 do not consider changing the scope restrictions in IAS 40.3-4.
- 26. The staff have not considered the option of only extending the scope of IAS 40 to include telecom towers because the staff believe there is no basis for making the

distinction for towers, but not other structures in paragraph 14 if they are used in similar business model.

Option 1 - Keep existing limitation

27. The staff have identified what we think are the advantages and disadvantages of keeping the existing limitation in paragraphs 22-23, assuming a strict reading of the definition of a building, ie must have walls and a roof.

Option 2 - Structures fixed to land or buildings on a permanent basis

28. Option 2 is not based on a clear principle. However, some interested parties, eg tower companies in Indonesia, consider that structures fixed to land on a permanent basis meet the definition of a building. Furthermore, the staff do not think it is appropriate to account for structures used in a similar business model in a different way solely because a structure lacks physical characteristics such as walls or a roof. Consequently Option 2 considers that the IASB could allow this broader definition of a building and clarify this in IAS 40 to prevent the possibility for further diversity in practice.
29. Under Option 2, structures such as towers, advertising billboards, storage locations, oil storage tanks, power plant, stadiums, pipelines, fibre optic networks, pylons, solar farms, wind farms etc would all have the potential to be investment property if they meet the other criteria in IAS 40.

Option 3 - Cash flows to depend primarily upon location

30. The staff think that Option 3 would result in a similar outcome to Option 2. However, the staff note the IFRS Interpretation Committee recommended that the scope of IAS 40 should focus on the way the asset is used rather than by focusing on the physical characteristics of the structure or on whether it is fixed to land (see paragraph 5).
31. The staff think that another characteristic of investment property, as currently defined in IAS 40, that distinguishes it from owner occupied property is that the future cash flows to be earned from its use depend primarily upon its location. However, the staff think for most items of owner-occupied PPE, the productive capacity is also a primary factor affecting the generation of cash flows.

32. The staff think that in general most of the structures listed in paragraph 29 have the potential to be investment property if they meet the other criteria in IAS 40.

Option 4 - All non-financial assets

33. Options 1-3 have the potential to result in non-financial assets used in similar business models being subject to a different accounting treatment. Therefore, the staff think that conceptually Option 4 is the best option if the focus of IAS 40 is on the characteristic that investment property generates cash flows largely independently of other assets through rental and/or capital appreciation (see paragraph 18).
34. Under Option 4, there would be no limitation on the types of assets that could be considered investment property. Therefore the structures listed in paragraph 29 have the potential to be investment property if they meet the other criteria in IAS 40. Furthermore, so would movable assets such as a satellite or a ship.

Additional staff observations on relaxing the limitation

35. Whilst relaxing the restriction for investment property to be land and/or buildings may seem like a big step, the staff do not envisage it would necessarily have a significant effect in practice.
36. Tower companies in jurisdictions such as the US and Indonesia appear relatively unique in the sense that the steel structure of the tower requires minimal maintenance, the companies often provide no additional services to tenants, and the rental agreements with telecom companies are for very long terms and are likely to be renewed.
37. For many of the assets listed in paragraph 29, if they were held for rental purposes the staff envisages that the owner/lessor would provide additional services or hold the asset for its own use as well. For example, the staff would expect that some companies with storage locations will provide special care and handling for the items that they look after. The staff also think that rental agreements for moveable items such as vehicles are likely to include a significant repairs and maintenance service. Furthermore the staff envisages most items rented out for short period with tenants, such as space on advertising billboards, would require a significant service element

(eg maintaining the asset to a high degree because its visual appearance is important to encourage new tenants and modifying the asset to suit each new tenant's needs). If ancillary services are significant to the arrangements with tenants, these assets would remain in the scope of IAS 16 *Property, Plant and Equipment* regardless of whether they otherwise meet the definition of investment property.

38. The staff have identified two further considerations:
- (a) The effect of expanding the scope of IAS 40 may be to move certain assets out of the leasing standard and into IAS 40 for an owner/lessor. Consequently more leases of assets would fall into IAS 40 for the lessor.
 - (b) If the limitation on the scope of IAS 40 is relaxed the IASB may wish to consider whether to permit entities to choose to apply a different accounting model for different classes of investment property (see paragraph 22(d)).

Suggestions for further outreach

39. The real estate sector business model is sometimes described as a model where performance is better assessed by looking at the trend in the Net Asset Value (NAV) and valuing the business on a P/NAV basis. Consequently the staff think it would be helpful to compare the way investors look at real estate companies with companies holding different types of assets in a similar business model. Feedback from analysts in our outreach suggests that most analysts appear to primarily focus on the cash flows generated by towers but are concerned about the subjectivity involved in fair value measurements of towers. Therefore, the staff think it may be worth considering outreach to see how investors and analysts look at companies that own investment property for where there are infrequent market transactions (eg in rural locations or jurisdictions with less developed real estate markets) and where the investment property is generally only held for rental purposes. Outreach would involve assessing whether investors find the fair value estimates by those entities useful and whether they think changes in those estimates provide a good measure of performance of those entities. The staff think it a good starting point would be to consider academic research in this area.

40. The impact of relaxing the limitation for investment property to be land and/or buildings could affect a number of different industries (see paragraph 14). Consequently the staff think it may be better to initially perform further outreach by focusing on investor groups, eg CMAC, CRUFs etc, rather than specifically target investors and analysts covering specific industries. This is because most of the analysts we spoke to that follow tower companies covered only one or two sectors, which makes it difficult for the staff to compare the models used across many industries. Furthermore their analysis depends on their own preferred approach as well as the type of industry.
41. The staff would also suggest contacting the larger accounting firms to obtain their views on the audit implications of relaxing the limitation for investment property to be land and/or buildings, eg requiring fair value information for other types of non-financial assets.

Staff summary and recommendation

42. The aim of IAS 40 appears to be to introduce a fair value through profit or loss model for assets that generate cash flow largely independently of other assets through rental or capital appreciation (paragraph 18). The staff do not think there is a conceptual basis for including assets such as warehouses and office buildings used for rental purposes in IAS 40, but excluding other assets, like telecom towers, used in an identical business model with identical cash flow characteristics. Therefore, the staff conceptually prefer Option 4.
43. IAS 40 excludes items of property if the entity provides significant ancillary services to the occupants of that property (IAS 40.11). Consequently if the restriction for investment property to be land and/or buildings was relaxed, some assets (that might otherwise fall within the scope of IAS 40) may still be excluded because of services that are provided with the asset.
44. There currently appears to be limited demand to increase the scope of IAS 40 to include other structures. Plus, apart from tower companies in Indonesia, we are not aware of diversity in practice in how IAS 40 is being applied to assets other than land and/or buildings. (paragraph 22(c)). Nevertheless, based on our outreach, the business

model of the tower companies in Indonesia and in the US is thought to be an emerging business model. Although the diversity in practice may be limited, the question remains whether the predominant practice (outside Indonesia) of applying IAS 16 is the most appropriate accounting.

45. Many participants in our outreach expressed concern that fair value measurements of towers [could be] are very subjective because they are based on management's judgement, and hence [would] have limited use. Consequently, the staff also think that the IASB needs to consider whether in some industries the costs of requiring preparers to prepare fair value information for assets solely held for rental purposes may exceed the benefits to investors.
46. Consequently the staff recommend that the next step should be to undertake additional research as outlined in paragraphs 39-41 into the usefulness and audit implications of requiring fair value information if the IASB was to relax the scope restriction in IAS 40.

Question

Before investing further resources into undertaking this additional research, we wanted to present to the IASB the results of the outreach conducted to date, and to ask:

- 1) Does the IASB have any questions on the results and analysis of the outreach conducted to date?
- 2) Does the IASB agree with the staff recommendation to continue with the research in paragraphs 39-41 and to focus on option 4 described above?

Appendix: Detailed summary of feedback received during the outreach

Introduction

- A1. The staff performed outreach with:
- (a) four telecom companies and five tower companies:
 - (i) The four telecom companies are global operators.
 - (ii) Out of the five tower companies, two were based in the US and had global operations, and three were based in Indonesia.
 - (b) two investor relations departments of tower companies and five analysts that follow tower companies.
- A2. This appendix summarises the feedback received during the above outreach.

Feedback from tower companies and telecom companies

- A3. Paragraphs A4-A25 summarise the common feedback received from tower companies and telecom companies in the following areas:
- (a) on the current market practice of tower leasing around the world; and
 - (b) on the business model of tower companies to see if in any of those jurisdictions the business model is similar to that of investment property.

Current market practice of tower leasing around the world

- A4. A telecom company can obtain coverage in its desired locations by a number of methods:
- (a) Own, and in most cases manage, its own single occupant tower. This provides a competitive advantage and appears to be a common practice in many jurisdictions around the world. However, in some cases, that telecom company may enter into an arrangement with a third party, eg a tower company, to manage its towers, eg to provide security services or lease spare capacity on its tower to other telecom companies.

- (b) Entering into a network sharing arrangement with one or more other telecom companies for all or part of their network. Network sharing arrangements usually are entered into in some form of joint venture, joint arrangement or joint operation. Such arrangements appear to be a common practice in many European countries.
 - (c) Leasing the tower from a tower company. The tower company has ownership of the tower. Such arrangements are common in the US, parts of Asia (eg India, Indonesia, Malaysia), parts of Latin and Central America (eg Brazil, Mexico), Ghana, Uganda and some parts of Africa (eg Ghana, Uganda), excluding South Africa where telecom companies typically operate their own single tenant towers. In recent years there have been a number of transactions where telecom companies are selling their tower portfolios to tower companies.
- A5. Method (a) appears to be becoming less common in many jurisdictions in favour of methods (b) and (c) for the following reasons – reduction of costs and risks, sharing of/access to knowledge and better access to coverage particularly in remote locations. Also in some jurisdictions the law requires telecom companies to share the towers and will not permit multiple towers to be built in the same area.
- A6. In countries where telecom companies do not have the knowledge to operate and manage their own towers, or there are high security risks, there appears to be a greater tendency to lease space on a tower from a tower company or use a third party to manage the towers.
- A7. The staff note that in the outreach performed by the IFRS Interpretations Committee staff to IFASS in 2012, of the fifteen respondents, four respondents stated that they are aware of method (c) in their jurisdiction. One other jurisdiction said that method (c) is currently not common but will become relevant in the near future because of recent business developments in the jurisdiction.

Business model of tower companies (method (c) in paragraph A4)*Ownership of the land and tower*

- A8. Most telecom towers are built on land. However, a small percentage of the towers are erected on buildings or are mobile towers. Towers tend to be erected on buildings in locations where there is scarcity of land, eg in parts of large cities. Mobile towers, eg mounted on trucks, generally appear to be used as a temporary solution before a permanent tower is erected.
- A9. Tower companies own the towers, and often also own a shelter structure beneath the tower and a security fence surrounding the property. The tower consists of steel frames and other supporting components (there are no solid walls or floors).
- A10. Towers are usually either purchased as part of a portfolio, eg from telecom companies or other tower companies, or are built to order by the tower company for a particular telecom company tenant.
- A11. For the majority of towers, the tower companies leases the plot of the land beneath the towers. The land lessor is generally a third party, eg a farmer, that has land in the location required. Land leases are usually for long period—commonly ten years, with renewal options which appear to be nearly always exercised in practice. However, it appears that tower companies prefer to own the land and there has been an increase in the percentage of towers on owned land in recent years, particularly in the US.
- A12. Tower companies intend to hold the towers until the end of their economic life and so towers are held for rental purposes only, not capital appreciation. Furthermore, towers attached to land are permanent structures and are generally only moved if required by law. Costs to dismantle, relocate, and reconstruct the towers constructed on land appear to be significant (one estimate given was approximately 70% of the initial cost of constructing the tower). Furthermore, towers are built to form part of a network and their location is chosen to integrate with the other towers in the area. Consequently, if a tower is moved, it is likely to cause disruption to the network created by the surrounding towers.
- A13. The useful life of towers is typically estimated to be 20 years. The physical life of the towers is likely to be much longer but this estimate takes into account the

possibility of technological obsolescence, eg it is difficult to presume that delivery of mobile communication will continue in its current form for a longer period.

Agreements between tower companies and telecom companies

- A14. The tower company earns rental revenue from renting space on the tower to telecom companies. Tenants attach their own equipment. The tower company does not use its own equipment to provide the access to the network, other than the tower structure and shelter.

- A15. Towers are typically built with capacity for four or five tenants. Once a tower is built for an anchor tenant, or purchased (often from an anchor tenant), leasing incremental space on the tower to other telecom companies is highly profitable because the tower has a relatively fixed cost base.

- A16. Typically the tower company has a master agreement with each of its telecom company tenants. This master agreement covers general terms and sets parameters. There is an individual lease agreement for each tower that the telecom company rents space on which sets out the specific details of the lease. There is a need for individual agreements for each of the towers because the rental revenue can vary significantly based on the location of the tower, the type of equipment installed by the telecom company, how high up the tower the equipment is installed etc.

- A17. Individual lease agreements are entered into for long periods, for example up to ten years. Furthermore, in practice tenants generally renew their tenancies because once they have their equipment on the towers, to move to another tower would cause significant costs and network problems.

- A18. Lease agreements are structured in different ways depending on the tenant and the jurisdiction, but they are generally all structured to pass on the costs incurred by the tower companies, eg maintenance costs of the towers, any electricity incurred on behalf of the tenants and increases in the land lease rentals. For example, sometimes the telecom company has a direct contract with the electricity provider and other times the contract is with the tower company and the electricity cost is passed on in the lease agreement.

- A19. In many cases an exact spot/area on the tower is not specified in the lease agreement. It appears that the tower company is permitted to attach its antenna on the tower at a

specific height within some variations, and the amount of space the telecom company takes at that height is not specifically stated and is likely to depend on the size/capacity of the equipment.

- A20. A tower company often supplies its tenants with several towers in many locations, rather than a single site. However a telecom company can choose towers held by different tower companies in different locations. The network chain is built by the devices installed in the tower by the telecom companies. In that sense it appears that a tower generates cash flows independent of other towers/the rest of the network.

Ancillary services

- A21. In some jurisdictions, eg areas of Africa and India, the ancillary services provided by the tower companies to the telecom companies appear to be quite significant to the arrangement as a whole (one estimate given was these additional costs were approximately 65% of the fixed lease/infrastructure cost or account for up to 40% of total rental revenue). These services may include security, maintenance of the company's equipment and the tower, installation of the telecom company's equipment (incl. linking to power supply), reducing energy costs and ensuring electricity is available via a generator in areas which may not have a well-established national grid.
- A22. However in other jurisdictions, eg the US and Indonesia, the tower company usually only covers maintenance of the tower. The telecom company is generally required to install and maintain its own equipment. The cost of maintaining the tower seems to be a relatively small part of the overall arrangement (estimates given were maintenance costs were approximately 5-10% of total rental revenue and revenue from maintenance services was around 15-20% of total rental revenue).
- A23. In rare cases tower companies may also help telecom companies to identify sites where they need additional network coverage. However, in most cases the telecom companies do this themselves because they know where they lack coverage. However, tower companies will market available space on their existing towers to telecom companies.

Fair value measurement

- A24. All of the Indonesian tower companies in our outreach are applying a fair value through profit or loss approach because they consider telecom towers to be investment property, including meeting the definition of a building. However one tower company in Indonesia that we were unable to contact measures the towers under a revaluation model because it considers the towers to be PPE (both based on the definition of a building and that fact it considers ancillary services to be significant to the arrangement). Fair value measurements of the towers by the companies are based on a combination of a cost and income approach and performed by an independent appraiser. One tower company noted that it is not complex to apply a discounted cash flow approach to the towers because the agreements with tenants are usually long term and they can essentially just roll forward most of the cash flow projections.
- A25. The US tower companies are currently applying a cost model under US GAAP. However they are reporting similar metrics as rental buildings such as office buildings and shopping malls for their investors. They noted that fair value may be of some use to investors but expressed concern about the amount of work involved in determining fair value for all their towers and also the audit implications.

Investors following tower companies

- A26. Paragraphs A27-A32 summarise the common feedback received from participants from the investor relations departments of tower companies and analysts following tower companies.
- A27. Most of the participants noted that cash flow generation and growth in cash flows is the primary focus of investors and analysts. There were mixed views on whether investors and analysts would prefer towers to be accounted for at fair value through profit or loss. Some of the participants agreed fair value information is more relevant than cost information about the towers. However most also expressed concern that fair value measurements of towers [could be] are very subjective because they are based on management's judgement, and hence [would] have limited use and may be misleading. Some analysts said they would do their own fair value calculation based

on their estimates of the cash flows from the towers rather than consider the estimates of management.

- A28. The views of the analysts seem to depend on the models that they use to value tower companies and most of these models are closely linked to the fact that the cash flows are the primary focus. In Indonesia it appears that most analysts consider a type of EBITDAF (earnings before interest tax depreciation amortisation and fair value adjustments) approach to valuing tower companies because in their view this metric best tracks the share price. These participants noted that because they use this metric it does not really matter what how the tower companies account for the towers as long as they disclose their methodology. Furthermore the analysts following this method generally do not place much importance on having fair value information. In the US a common metric used to value tower companies that also has a cash flow focus is AFFO (adjusted funds from operations).
- A29. One US analyst we spoke to uses a net asset value (NAV) model to value tower companies and real estate companies. This was the only analyst in the outreach that follows both typical real estate companies and tower companies. This analyst noted that independently verified fair value information and information about changes in fair value would be extremely useful to him. He noted that he was indifferent in whether changes in fair value were recognised in profit or loss or not because he did not focus on earnings.
- A30. There was one exception to analysts using a cash flow based approach. One analyst in Indonesia noted that he uses an earnings based model and he said that recognising changes in fair value in profit or loss makes profit unpredictable and is not helpful in assessing the performance of the company. Furthermore he noted that he would prefer to have cost information, including depreciation, than fair value information.
- A31. There seemed to be general agreement amongst participants that the tower industry has a lot in common with real estate, in particular office buildings and shopping malls and that the cash flow characteristics of the assets are similar. Some of the investors also agreed that there were similarities with other assets, eg companies with advertising billboards and gas storage tanks.

- A32. One investor in the US noted there is a trend of companies renting out space on towers, other telecommunication assets, advertising billboards and storage locations qualifying as a Real Estate Investment Trusts (REITs) in the US, and hence receiving special tax treatment. He also noted that, in the future, he thinks we will see more companies with these business models, eg companies that own assets such as oil pipelines, solar farms, wind farms and fibre optic networks. Two recent example of companies with this activity:
- (a) CBS Corp plans to sell its remaining stake in its outdoor advertising division (CBS Outdoors) later this year. CBS Outdoors will convert to a REIT¹.
 - (b) Windstream plans to demerge its fiber and copper networks in 2015 in a REIT. Windstream will have a long-term lease with the buyer to continue to use the network, and the REIT will also be able to lease capacity on the networks to other companies².
- A33. The staff note that the staff of the big accounting firms had also identified these types of industries as similar to the telecom tower business model during outreach by the Interpretations Committee staff in 2013.

¹ <http://www.cbcorporation.com/news-article.php?id=1043>

² http://news.windstream.com/article_display.cfm?article_id=1561