PALISTAR

Investing in mission-critical digital infrastructure: Finding the needle in the haystack

Jorge Fernandez, Institutional Real Estate, Inc.'s managing director, infrastructure, recently spoke with **Omar Jaffrey,** founder and managing partner at **Palistar,** about the challenges and benefits of investing in cell towers, broadband and fiber infrastructure. Following is an excerpt of that conversation.

How did you come to be a telecom investor?

Today, Palistar is one of the leading developers and acquirers of macro cell towers, i.e. wireless macro, in the world, as well as an investor in other mission critical digital infrastructure. But we didn't start out like that. I became interested in investing in digital infrastructure about 15 years ago. I had been, up to then, an investment banker in the telecommunications ecosystem, going back to the 1980s and was always on the lookout for undercapitalized sectors with strong tailwinds. I started raising capital for telecom because I thought the sector was a unique ecosystem. It was growing very quickly. It served a social need. It enabled the economy. COVID forced everyone to school and work from home, and you realized some people have good, adequate infrastructure, but many don't. There was a real digital divide – a world of haves and have nots. That acted as an accelerant for investors to start investing in this ecosystem. I used to advise people who invested in it, and now I have the privilege of raising capital and investing in this ecosystem myself.

Why did you focus on the macro wireless subsector of telecom?

This wireless subsector is the most resilient infrastructure sector in the world. It has performed incredibly well. It survived COVID; it survived a global financial crisis. No matter what national crisis you think of, we still need wireless infrastructure. When things went down during Katrina, the first thing the area did was bring back the wireless infrastructure so cell phones would work. It's the thing governments and companies will not allow to go down.

Most market participants underwrite macro cell tower opportunities and assets to generate high single-digit returns, but you've been able to generate outsized returns. How have you done that?

The macro wireless subsector is a unique subsector of digital infrastructure. Typically, each tower has four slots to rent to wireless carriers. The tower owner starts off with one tenant and then adds a second, third and fourth. However, if you have three tenants, the likelihood of getting four is low because there are really only three major wireless carriers in the country – AT&T, T-Mobile and Verizon. So, the growth of your tenancy slows down as you have more tenants.

There are a couple of ways to invest. I can buy a fully leased location and just take over the cash flow. This would be similar to investing in a bond. Or I can buy towers with open spots and increase cash flow by renting those empty spots. This is what I do. If there's one tenant, I'll pay you more because I'll grow my cash flow by 100 percent when I get a second tenant. We try to find the locations that have less tenancy – not no tenancy, just less tenancy – and we try to grow the tenancy. When you buy it with one tenant, or you build it for one tenant, then you've got 100 percent upside for getting the second tenant or 200 percent for a third tenant. We specialize in that area.

We also specialize in the middle market, which means we invest in things lower than a billion dollars. If I had billions to invest, I'd be pushed into buying bigger scale. The moment I'm buying bigger scale, it gets awfully competitive. We spend an inordinate amount of time trying to find that one asset that has the most growth potential over a 10-year horizon. It's not like the AI growth, but it's a very nice 10 percent growth. Plus, we're getting cash flow from day one. By doing the hard work of finding those singular assets, we're able to deliver mid-teen-plus returns when others who buy the more mature assets will generate 8 percent or 9 percent returns.

How do you bring efficiencies into the process when you are buying one asset at a time?

We are trying to find that needle in a haystack but do it at scale. Buying one asset is not very interesting. If I can find a thousand assets one at a time, that's interesting. We have spent years developing a technological infrastructure and an experienced team where we're able to find these single assets that have lower tenancy but are in locations that should support more. It's not easy, but we've been doing this for over a decade and our process is very difficult to replicate. You have to be able to scour the country. You have to have a tremendous amount of patience. You have to have deep relationships with the AT&Ts, Verizons and T-Mobiles of the world. You have to do a lot of hard work. Most private equity firms aren't set up to do that granular hard work. They're set up to go buy something in scale, and they're set up to use leverage in scale.

What goes into developing these towers?

Tower development is very clear-cut. I can't just build a tower and hope tenants come. I only have three customers – AT&T, T-Mobile and Verizon – to build for. I need to build where they want a tower. Because my customer base is so finite, I really need to take their leadership on where they need something. Over time, we have built deep relationships with these carriers, so they will come to us and tell us they need better coverage within a specific geo-location, and we'll do the legwork to find the right spot. If the carrier and community approve the location, the carrier will sign a contract agreeing to lease space on the tower upon completion. So, we start development already preleased. This industry doesn't allow for speculation. Traditional real estate has an element of speculation in it. We have zero. We're the largest builder of towers, but not speculatively.

We're also the largest acquirer of individual assets. There are hundreds of thousands of individual towers/wireless assets that my team looks at to find those with an upside. We're the only firm in the world that both acquires and develops towers/wireless assets to scale. If you do this properly, you'll make high-teen returns from relatively lower-risk opportunities.

You've recently closed two funds. What sectors did you focus on and which ones did you avoid?

We were very intentional in our investment. We launched the funds when everyone was doing data centers and fiber. We looked at billions and billions of dollars of fiber, and we looked at billions and billions of dollars of data centers, and we chose not to invest in either of them as control buyers. My job as an investor is not to chase whatever everyone else is chasing. With the limited capital I have, I want to make sure the money is protected while still making solid returns. Both of these funds contained lots of macro wireless investments because that is where we saw the best returns with the least risk.

Post-COVID, there was an incredible amount of investment in broadband and data centers because interest rates went down to zero. When money is free, you can borrow a lot and invest it at high valuations.

So, you could easily get in, but how do you get out? In our evaluation of an investment opportunity, we would stumble on the valuation. We would stumble on the business plan being uber-aggressive. We would stumble on the exit scenarios. Those three things really made me nervous, and we pulled back from control investments in data centers.

We held off on investing in broadband when everyone else was doing it, but three years ago when the euphoric phase had passed, we started investing actively, and we did very well. We delivered close to 20 percent returns, whereas others who jumped in too early have had challenges. Our conservatism, which initially everybody was criticizing, proved out in the end.

We currently do not own a data center platform. Hopefully, when valuation is a little more sober, and demand/supply balances are a little more in our favor, we will do so. But in the interim, we're trying to provide the picks and shovels for it. As an example, we're in very advanced negotiations to invest in a company that provides the fiber to the data center. That fiber has hard contracts from "hyperscalers" — companies like Meta and Google. It makes more sense to me to invest with strong customers. As I've mentioned, we have also been leaning into broadband for the past three years. We've done a partnership with a carrier in Canada where we're building the fiber for them, and they're giving us a strong return.

What do you look for when deciding to invest?

We need to make reasonable returns, and we need to see an exit. I think those two things are really important. We don't have unlimited money, and we don't have unlimited time. We're very active in broadband and data centers. However, we have had more success deploying capital the way we would like to in wireless. I certainly think that'll continue to be the case for us because we've now created these unique mousetraps and partnerships that others can't copy. If I'm just another guy chasing that same deal with 100 other guys, then I don't really do anything special. We're constantly trying to find some edge, and if we don't find any edge, we just don't need to do it.

You mentioned the bandwagon for investing in data centers. What about AI?

I was around at the dawn of the Internet in the late '80s and the early '90s. What's enabling AI is a tectonic shift in compute. For years, the CPU that you had in your computer was getting faster and faster. That's a linear progression of things. Then Nvidia produced chipsets that worked in parallel. Everything happened at once. The AI companies were able to use this parallel processing and apply it to compute and change the way a lot of things are done. We're just scratching the surface of the things that can be done using AI, but it is a monumental opportunity. I'm super excited about it. I'm glad it happened in my lifetime so I can be a participant in it, but I don't want to make speculative bets. In this massive opportunity set, I'm trying to find ways that are slow and steady and deliver mid-teen returns. We need to stay on top of the changes so we can find the slow and steady in there.

What keeps you up at night?

The telecom industry is huge. It's trillions and trillions of dollars. I'm trying to find the tens of millions or the hundreds of millions that are sensible. I'm worried that I'm going to get drawn into the hype, change my style of investing and actually start chasing super aggressive things. We need to stay true to our knitting as a business and what we told investors we would do. I also think about the people I employ and work with. At the end of the day, this is a people business. Managing, growing and keeping my people happy is probably the number one issue I face on a day-to-day basis. We also deal with a lot of counterparties. It takes years to build those relationships. It takes a second to blow them up. We spend an inordinate amount of our time crafting, creating, nurturing and respecting those relationships. Somebody in my position needs to be focused on the human capital and being true to their investment thesis, but eyes wide open to what's occurring. You can't stick your head in the sand and pretend the industry is not evolving because then you're going to lose out like AOL and others did.

It's a balancing act because if you pretend new opportunities don't exist for too long, then you completely miss out. But at the end of the day, my job is to protect principal, deliver solid returns, and exit. If I overlay those tenets on investment possibilities, I should come to the right decision. You just have to be constantly vigilant with eyes wide open. That's what will serve you and your investors well.

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CORPORATE OVERVIEW

Palistar Capital is an alternative asset manager led by managing partner and founder, Omar Jaffrey, focused on digital infrastructure investments. The firm seeks to invest through direct asset ownership as well as by developing innovative financing solutions to complex problems for leading global digital infrastructure-related companies. To learn more about Palistar, visit www.palistar.com.

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