The Safest and Strongest Net-Lease REIT with a 5.8% Dividend Yield

This REIT is one of the largest net-lease REITs benefiting from the unmatched diversity in its portfolio and its deep expertise in sale-leasebacks. The portfolio has displayed very strong resilience to the pandemic, as its rent collections have remained strong throughout. It also has an impressive dividend history with consecutive dividend increases every year since it went public in 1998. We are also encouraged by its successful track record of operating through economic downturns and using them to build and grow a high-quality portfolio through opportunistic investing. Despite all the odds in favor, the stock has underperformed this year. We believe at the current price, the REIT offers an attractive investment opportunity from an income generation, capital preservation, and capital appreciation perspective. This article reviews the health of the business, valuation, risks, dividend safety, and concludes with our opinion about why it's worth considering if you are a long-term income-focused and growth-oriented investor.

Key Takeaways:

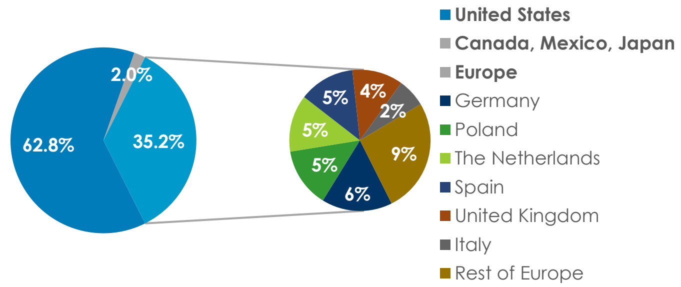
- Well diversified, high-quality portfolio.
- Successful track record of operating through downturns.
- Strong liquidity profile.
- 23 consecutive years of dividend increases.

Overview: W.P. Carey (WPC)

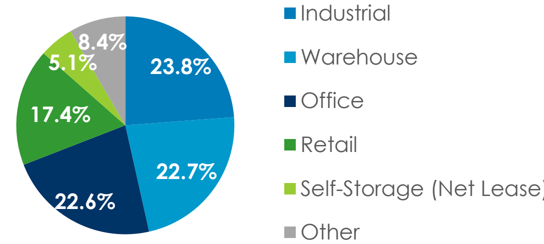
We are referring to W. P. Carey Inc. (WPC). WPC is a real estate investment trust (REIT) that invests in "operationally-critical, single-tenant" commercial real estate; and through a sale-leaseback model, leases the properties to companies located across 25 countries primarily in North America and Europe on a long-term triple-net lease basis. As of September 30, 2020, the company's owned portfolio consisted a total of 1,215 industrial, warehouse, office, retail and self-storage properties covering ~142 million square feet and generating ~$1.2 billion in annualized base rent (ABR).

While the US accounts for ~63% of its ABR, the company's international presence is also sizeable, with ~35% of ABR coming from Northern and Western Europe, and ~2% from Canada, Mexico and Japan. By property type, the currently high-in-demand industrial and warehouse properties jointly account for ~47% of the ABR, while the office, retail, self-storage and other properties bring in the rest of the company's rentals.

Diversification By Geography



Diversification By Property Type



Source: 3Q20 Supplemental

WPC's tenant base is also well-diversified as its properties are net leased to 351 tenants with a weighted average lease term (WALR) of 10.6 years. No single tenant accounts for more than 3.3% of the ABR, and the top 10 tenants represent about 21.7% of the ABR and have a higher WALR (12.6 years) compared to the overall portfolio.

Top 10 Tenants

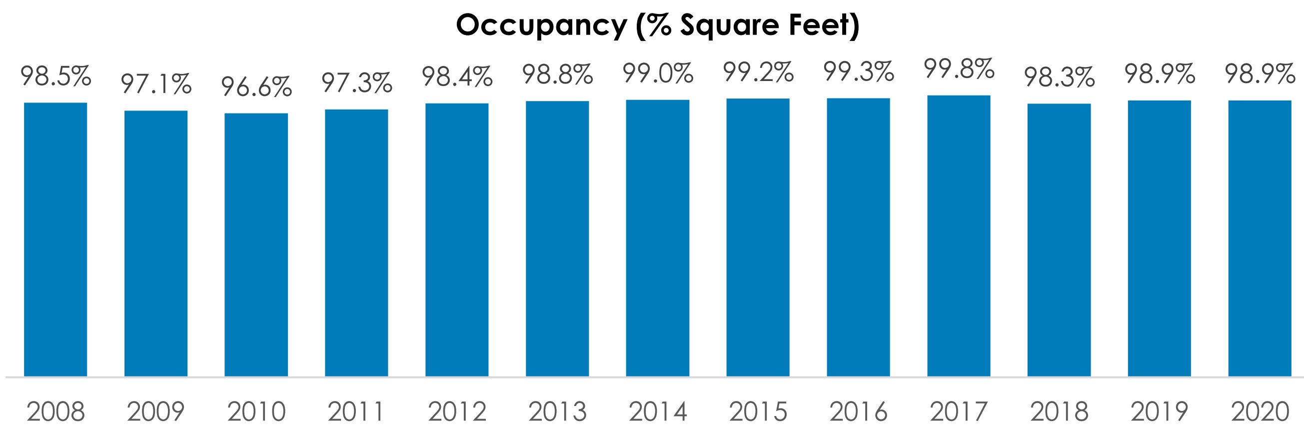
Tenant	Description	Number of Properties	ABR ($ millions)	WALT (years)	% of Total
U-HAUL	Net lease self-storage properties in the U.S.	78	$39	3.6	3.3%
HELLWEG	Do-it-yourself retail properties in Germany	42	35	16.4	3.0%
State of Andalucia	Government office properties in Spain	70	30	14.2	2.6%
METRO	Business-to-business wholesale stores in Italy & Germany	20	28	6.5	2.5%
Pendragon PLC	Automotive dealerships in the United Kingdom	69	22	9.7	1.9%
ExtraSpace Storage	Net lease self-storage properties in the U.S.	27	20	23.6	1.8%
Marriott	Net lease hotel properties in the U.S.	18	20	3.1	1.7%
Nord Anglia Education	K-12 private schools in the U.S.	3	19	23.0	1.7%
Forterra	Industrial properties in the U.S. and Canada	27	19	22.7	1.6%
Advance Auto Parts	Distribution facilities in the U.S.	30	18	12.3	1.6%
Top 10		**384**	**$250**	**12.6 yrs**	**21.7%**

Source: 3Q20 Presentation

Additionally, WPC has an investment management arm that has a total of $2.8 billion in assets under management (AUM). It currently provides investment advisory services to two non-traded managed investment programs - Corporate Property Associates 18 (CPA:18) and Carey European Student Housing (CESH) Fund. The company has ceased raising capital for new or existing funds, but intends to continue to manage them through the end of their respective life cycles. This shows that WPC is on its way to becoming a pure-play net-lease REIT in the future.

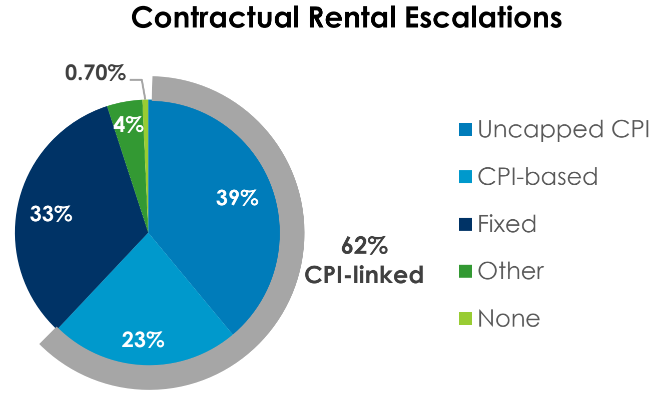
Successful Track Record of Operating Through Economic Cycles

WPC has developed deep expertise in sale-leaseback transactions over the years, which, combined with the diversity of its portfolio has helped it successfully operate through various economic cycles. WPC generally tends to originate its own deals, which gives it greater access to the seller's business profile and financial position. This allows it to draft stronger lease contracts with built-in rent escalators. On the other hand, the sellers (generally cash-strapped companies looking to shore up their balance sheet during difficult times) happily agree to such contracts as they get the flexibility to monetize their owned properties while retaining the all-important access to those vital properties. This approach has immensely helped WPC maintain stable occupancy levels even during times of economic downturn.



Source: 3Q20 Presentation

Further, the fixed rental escalations on contracted leases provide guaranteed internal growth of the recurring rental revenues. This helps WPC maintain a steady, albeit slow, annual ABR growth trajectory on its property portfolio as measured by the same-store growth rate. Currently, ~99% of WPC's contracted leases have built-in fixed annual rent escalations. This includes ~62% linked to CPI, which provides the company protection against inflation.



Source: 3Q20 Presentation

Also, unlike its peers who have struggled with rent collections through the COVID pandemic, WPC's rent collections have been stable. Since most of the properties net leased by WPC are operationally critical to its tenants, they tend to timely fulfil their rent obligations. Accordingly, the company's rent collections have been tracking at over 96% since the pandemic broke out, and with the recent rebounding of economic activity in the most affected sectors, and as a result of the restructuring of certain leases in the fitness, theatre and restaurant segments, WPC's most recent rent collections have further improved and stand at 99% with no further deferral requests from tenants.

Rent Collections

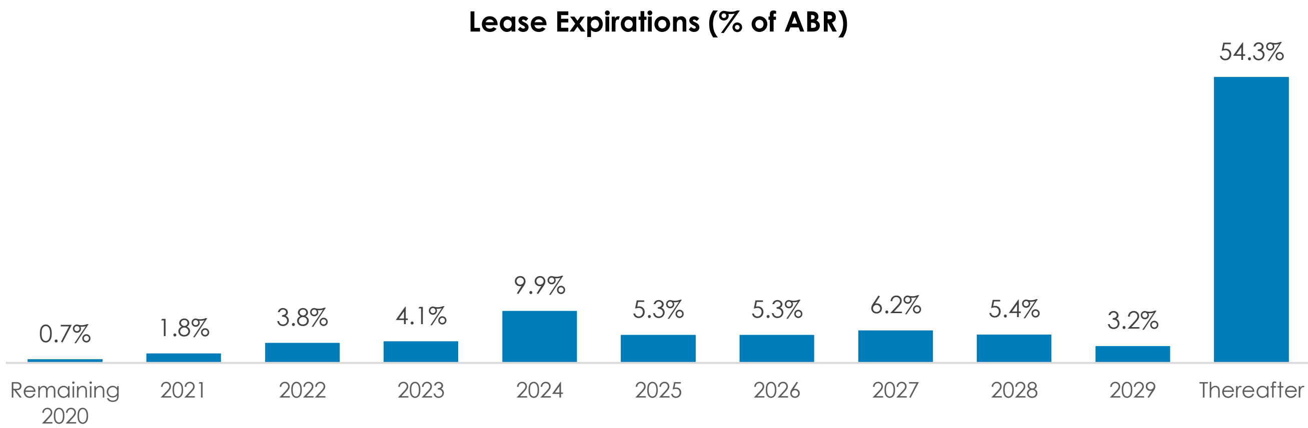
	April	May	June	July	August	September	October
Rent Paid	97%	96%	98%	99%	98%	99%	99%
Rent Deferred	0%	2%	1%	0.5%	1%	0%	0%
Rent Not Paid	3%	2%	1%	1%	1%	1%	1%

	2Q20		3Q20		October 2020	
Property Type	% of ABR	Rent Collection	% of ABR	Rent Collection	% of ABR	Rent Collection
Industrial	24%	98%	24%	99%	24%	100%
Warehouse	22%	94%	22%	94%	23%	99%
Office	23%	99%	23%	100%	23%	100%
Retail	17%	98%	17%	100%	17%	100%
Self-Storage (Net Lease)	5%	100%	5%	100%	5%	100%
Fitness, Theatres and Restaurants	2%	37%	2%	65%	1%	83%
Other	7%	98%	7%	98%	7%	97%
Total		**96%**		**98%**		**99%**

Source: Company data

Growing Through Opportunistic Investments

Of late, there have been some concerns surrounding the near-term expirations of certain leases, particularly related to a couple of its largest tenants, U-Haul and Marriot in 2024, which jointly account for about 5% of ABR, and the impact of these expirations on the company's longer-term growth trajectory. We believe these concerns are unfounded as WPC is increasingly getting involved in opportunistic property acquisition activity to grow its portfolio and enhance its longer-term growth trajectory.



Source: 3Q20 Presentation

As a matter of fact, WPC has a long history of following an opportunistic investment approach that allows it to continuously invest in almost any market situation. A testament of its successful strategy of opportunistic investing are its recent deals in the industrials and warehouse spaces which have largely remained insulated against the negative impacts of COVID. The company has not only locked in longer lease terms with fixed rental escalations on these deals but has also locked in attractive cap rates to generate wider spreads over its cost of capital.

In the recently concluded earnings quarter, WPC executed $112 million worth of industrial and warehouse investments that included two industrial sale-leasebacks in the US featuring lease terms of 25 years and 15 years and fixed annual rent escalations, and a warehouse expansion project for a grocery tenant in Lisbon, Portugal, which led to the expansion of the current lease term to 20 years. These investments had a weighted average going-in cash cap rate of 6.5%, providing a good spread to the company's cost of capital of ~4.4%.

During the most-recent 3Q20 conference call, WPC mentioned that going forward, it remains heavily biased toward industrials and any investment in other areas will purely be opportunistic. Office investments will likely be conservative underwriting requiring stronger tenant credits and longer lease terms, while retail investments will more likely be in Europe where WPC can take advantage of better supply fundamentals, pricing dynamics, and less competition to generate wider spreads.

"I think you'll continue to see us do more in industrial. That's been the bulk of what we've done this year-to-date. It's the bulk of what's in our pipeline. But we are diversified, and that's a good benefit where it gives us more pathways to grow." - ***Jason E. Fox, CEO*** on 3Q20 call.

In line with its outlook, the company completed an additional $187 million worth of transactions after 3Q20, including two industrial investments totalling $85 million with a weighted average lease term of 20 years, and one European retail investment worth $102 million. Altogether these transactions bring the year-to-date transactions volume to ~$700 million at an estimated cap rate of +6%, which is quite impressive given that the cap rates have continued to compress, particularly for industrial assets in the US. These investments also go on to show that WPC is tactically building its portfolio with the most suitable asset types—according to the overall market situation—to support its long-term growth.

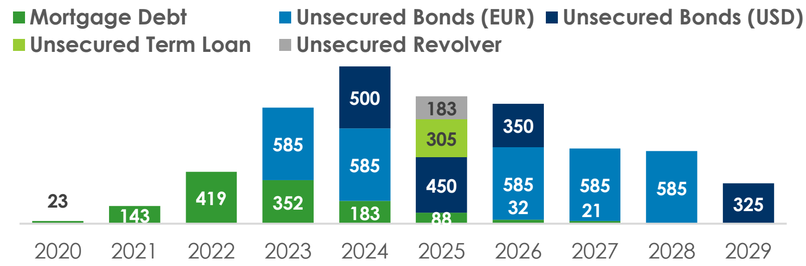
Ample Liquidity Complements the Investment Strategy

In recent years, WPC has made a lot of progress with regards to its ability to raise capital at beneficial pricing to support its opportunistic investment activity. The company completed an equity forward agreement in June which provided it with significant flexibility to match the funding of deals in its pipeline with equity issued at a predetermined price. So far, WPC has raised a total of $200 million by issuing 2.95 million shares under the agreement (including $100 million raised towards the end of 3Q20), still leaving it with the ability to issue an additional 2.5 million shares to raise ~$166 million at its disposal. This financing agreement brought the company's total liquidity to $1.9 billion (including $1.6 billion of availability on credit facilities, and $152 million in cash on hand) at the end of 3Q20.

In addition, WPC issued $500 million worth of senior unsecured notes in October which further enhances its liquidity profile. We note that these notes were offered at the tightest ever spread to the benchmark 10-year treasury rate and the lowest ever coupon rate of 2.4% for a 10-year net-lease bond, exemplifying WPC's strength in tapping the capital markets at the most beneficial rates.

While the amount of debt taken on the balance sheet to maintain a strong liquidity position does raise some concerns, WPC has the debt repayments favorably structured and decently covered through its EBITDA generation. At the end of 3Q20, the company's Net debt to EBITDA ratio stood at 6.1x. Going forward, it anticipates the ratio to reduce below 6x as it raises more equity capital under the equity forward agreements. Also, the total debt to gross assets ratio remains strong at 40.6% and is at the lower end of the company's target range.

Debt Maturity Schedule



Leverage Metrics	
Pro Rata Net Debt / Adjusted EBITDA (2)(4)	6.1x
Pro Rata Net Debt / Enterprise Value (1)(2)	35.6%
Total Consolidated Debt / Gross Assets (3)	40.6%
Weighted Average Interest Rate (pro rata)	3.0%
Weighted Average Debt Maturity (pro rata)	4.6 years

Source: [3Q20 Presentation]

Further, WPC also effectively uses its strong liquidity position to reduce the higher cost liabilities on its balance sheet. During 3Q20, it repaid mortgage debt of $192 million which had a weighted average interest rate of 5.1%. This reduced total secured debt as a percentage of gross assets to 8% vs. 12% a year ago and unencumbered an additional $30 million of ABR in the process.

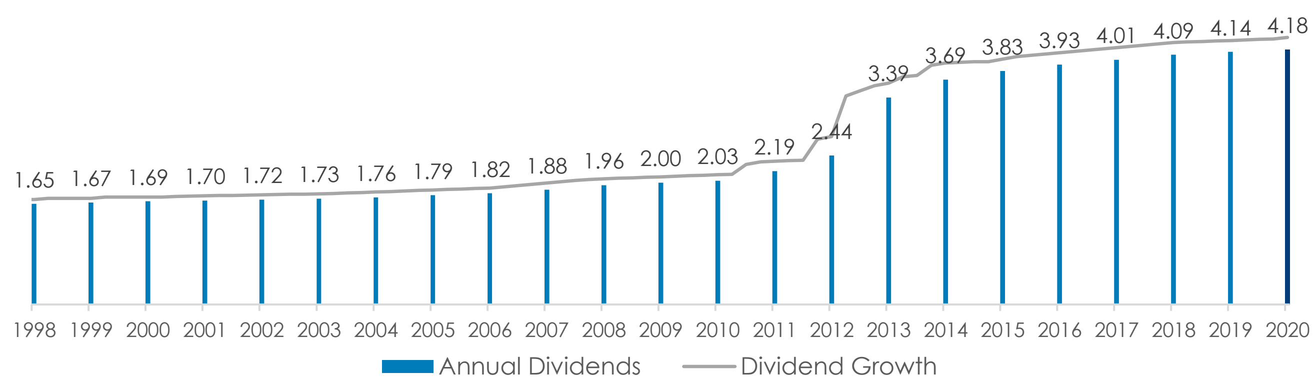
Overall, we remain confident that WPC will tactfully use its strong liquidity profile to continue to execute opportunistic investments and capitalize on the near-term growth opportunities stemming from market dislocations happening due to the pandemic, while maintaining the quality of its real-estate portfolio for sustainable long-term growth.

Growing and Safe Dividends

Income oriented investors typically buy into real estate investment trusts because their operating structure as a REIT requires them to pay at least 90% of their taxable income to shareholders as dividends. Amid the uncertainties caused by the pandemic, many REITs have reduced or suspended their dividend payouts.

WPC on the contrary has continued to pay what it considers a "conservative dividend" through the pandemic, while actually increasing it every quarter. Counting this year's dividend increase, the company has continuously increased its dividends for 23 years now, i.e. every year since it went public in 1998.

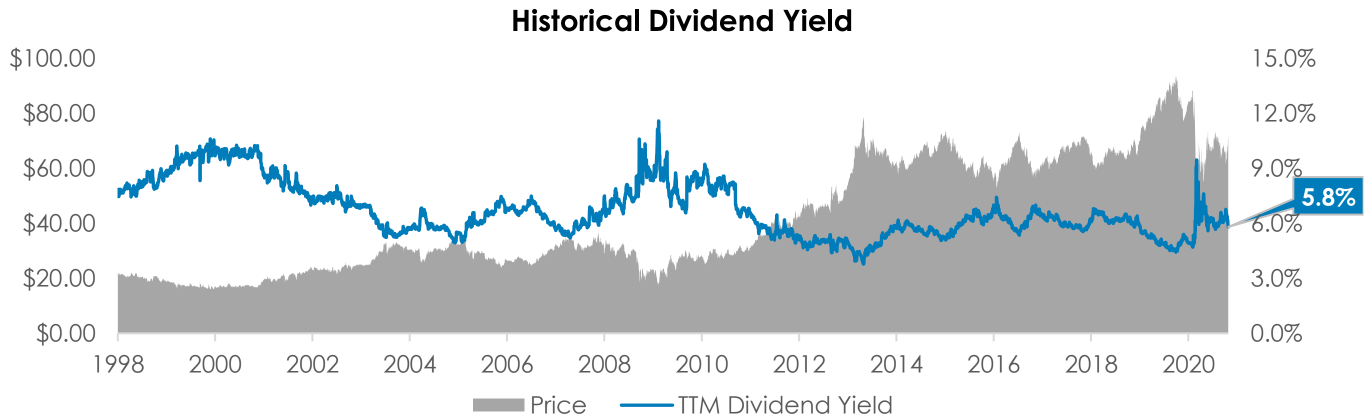
Historical Dividend Growth



Source: Company data

While the dividend has consistently grown over the years, the rate of growth in dividends has slowed recently. Nevertheless, WPC pays out an increasingly large portion of its adjusted funds from operations (AFFO) in dividends – it paid ~91% of its AFFO in the most recent quarter compared to ~80% in the comparable period in the previous year. For the full year 2020, the annual expected dividend payment of $4.18 implies a dividend payout of ~90% of the expected AFFO of $4.70 at the mid-point of the AFFO guidance range. This certainly looks like a very good payout ratio, considering the company views this as "conservative".

Further, the expected annual dividend for 2020 yields ~5.8% versus the current share price, which looks attractive considering the safety WPC provides in terms of dividend payouts, and of course, the current low-interest rate environment where the yields on fixed-rate securities are extremely low.

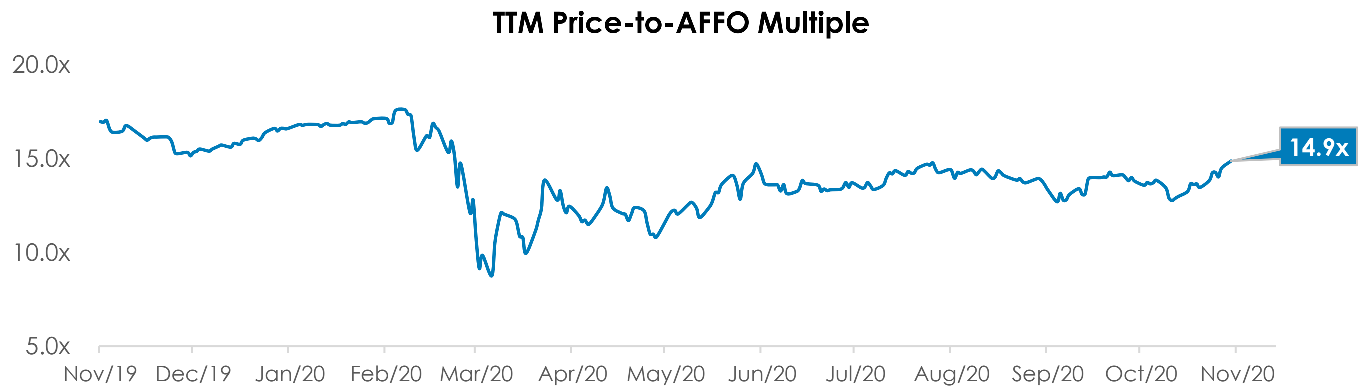


Source: Yahoo Finance, Company data, Blue Harbinger Research

Going forward, with a solid base to grow - both internally through built-in rent escalations, and externally through opportunistic investments, we believe the company will generate incremental funds from its operations and continue to grow its dividends to become a dividend aristocrat in the near future.

Valuation:

Since 2018, WPC's shares have traded in the TTM Price-to-AFFO multiple range of 8.8x-18.5x. Understandably, the shares reached the lower end of the multiple in March this year, when the entire REIT universe witnessed a sell-off because of the COVID pandemic. Although the shares have recovered since then and currently trade at a TTM Price-to-AFFO multiple of 14.9x and 2020E Price-to-AFFO multiple of 15.3x, they are still at a hefty discount to the multiples they were trading at just about a year ago.



Source: Yahoo Finance, Company data

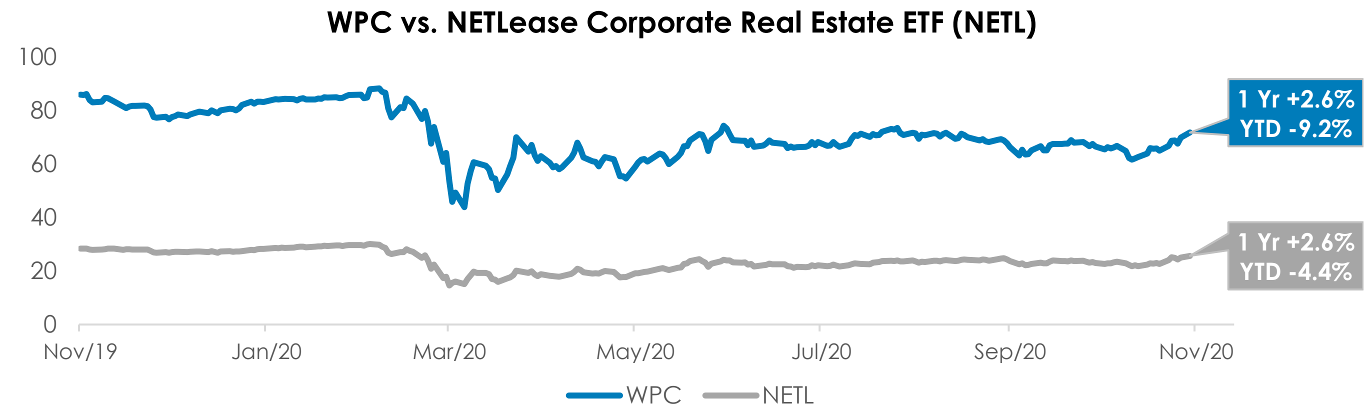
To gauge the valuation of WPC's shares on a comparative basis, we compared WPC to other diversified net-lease REITs. Specifically, on a TTM Price-to-AFFO basis, WPC is trading in line with the average of the peer group. However, if we take out the outlier peer company GNL, WPC is actually trading at a discount to its other peers. Also, in terms of dividend yields and dividend payout ratio, WPC is better placed than the rest of the peer group.

Name	Ticker	Market Cap ($ bn)	TTM Price/AFFO	Dividend Yield	Net Debt/ EBITDA	Interest Coverage Ratio (TTM)	Payout Ratio*
Realty Income Corp.	O	22.1	18.9x	4.36%	5.7x	2.8	81.5%
STORE Capital Corp.	STOR	8.4	17.2x	4.42%	5.6x	2.4	74.6%
VEREIT Inc.	VER	8.0	11.9x	4.14%	5.6x	2.0	55.6%
Lexington Realty Trust	LXP	3.0	14.3x	3.91%	4.9x	1.8	54.5%
Global Net Lease Inc.	GNL	1.5	9.6x	9.40%	7.4x	1.5	105.1%
W.P. Carey Inc.	**WPC**	**12.5**	**14.9x**	**5.82%**	**6.1x**	**2.6**	**86.3%**
Average			**14.5x**	**5.34%**	**5.9x**	**2.2**	**76.3%**

* Based on AFFO

Source: Yahoo Finance, Company data, Blue Harbinger Research

We also compared WPC's share price performance with the NETLease Corporate Real Estate ETF (NETL) which consists of net-lease REITs in the US and tracks the Fundamental Income Net Lease Real Estate Index. The share price of WPC has been moving almost perfectly in line with the index over the past year and generating a meager ~2.6% return. However, year-to-date, the shares of WPC have underperformed the index and lost about 9.2% of their value compared to the index's loss of 4.4%. This seems somewhat irrational to us, given the resiliency that WPC's portfolio has shown during the tough environment this year.



Source: Yahoo Finance

Overall, despite all the odds being in favor, we believe the shares of WPC are being grossly discounted by the market currently. We recommend income-focused investors, as well long-term investors looking for wealth creation opportunities, to buy into WPC, as the current share price presents an attractive opportunity to invest in an industry-leading and highly diversified triple net-lease REIT with a largely visible long-term growth trajectory.

Risks:

Tenant Bankruptcies: WPC is exposed to the risk of tenants not being able to meet their rental obligations owing to the difficult operating environment. However, WPC's diversification, across property types, geographies and tenants, and focus on operationally critical properties are the key mitigants to this risk. Nonetheless, should some of these tenants face financial trouble, it could lead to future fund flow interruption.

Interest rate risk: The US Federal Reserve has cut interest rates to near zero and even though we expect interest rates to remain relatively tame, dramatically rising rates could create challenges. As REITs are often seen as an alternative to bonds, higher interest rates could mean decreased demand for REITs, thereby causing a decline in their share price.

Further government-imposed lockdowns: Because WPC has a significant proportion of retail and office properties in its portfolio, any further lockdowns imposed by the government in case of a rise in the number of COVID19 cases might cause business closures. This can have an adverse impact on the company's operations.

Conclusion:

WPC fundamentally has a very strong business that is characterized by a well-diversified real estate portfolio net-leased for the long term and to high-quality tenants. Its rent collections have stood out throughout the pandemic as a result of its focus on operationally critical properties, and it has continued to find investment opportunities that are suitable to the overall market situation.

Its growth trajectory is highly visible with steady internal growth coming through contractual rent escalations, and strong external growth coming through opportunistic investments which are supported by the company's ability to raise capital at beneficial pricing.

Despite these strong underlying fundamentals and impressive operational performance through the tough economic environment caused by the pandemic, the company's stock has hardly moved. We believe the market is irrationally discounting WPC shares at present, and it will not be long before we see some positive momentum in the stock. Additionally, WPC has an impressive dividend history and its current dividend yield is quite attractive. Overall, the WPC shares looks extremely attractive from an income-generating, as well as from a longer-term wealth creation perspective.