# W.P. Carey & Co. LLC: Looking Global in 2002

## Interview with William P. Carey, Chairman, and Edward V. LaPuma, Executive Director

W. P. Carey & Co. LLC (NYSE: **WPC**), a real estate investment banking firm headquartered in New York City, is the largest publicly traded limited liability company in the world. Founded in 1973 by Chairman and Chief Executive Officer Wm. Polk Carey, the firm has developed a long and distinguished track record of working with some of the world's leading corporations to unlock the value of their real estate holdings by developing corporate financing solutions to meet their capital needs. They have accomplished this through the utilization of the corporate net lease or sale-leaseback financing structure in which they purchase a corporate property and then lease it back to the original tenant, often under a triple net lease lasting 10 to 20 years. W. P. Carey currently owns and/or manages more than 400 commercial and industrial properties throughout the United States and Europe comprised of more than 50 million square feet of space.

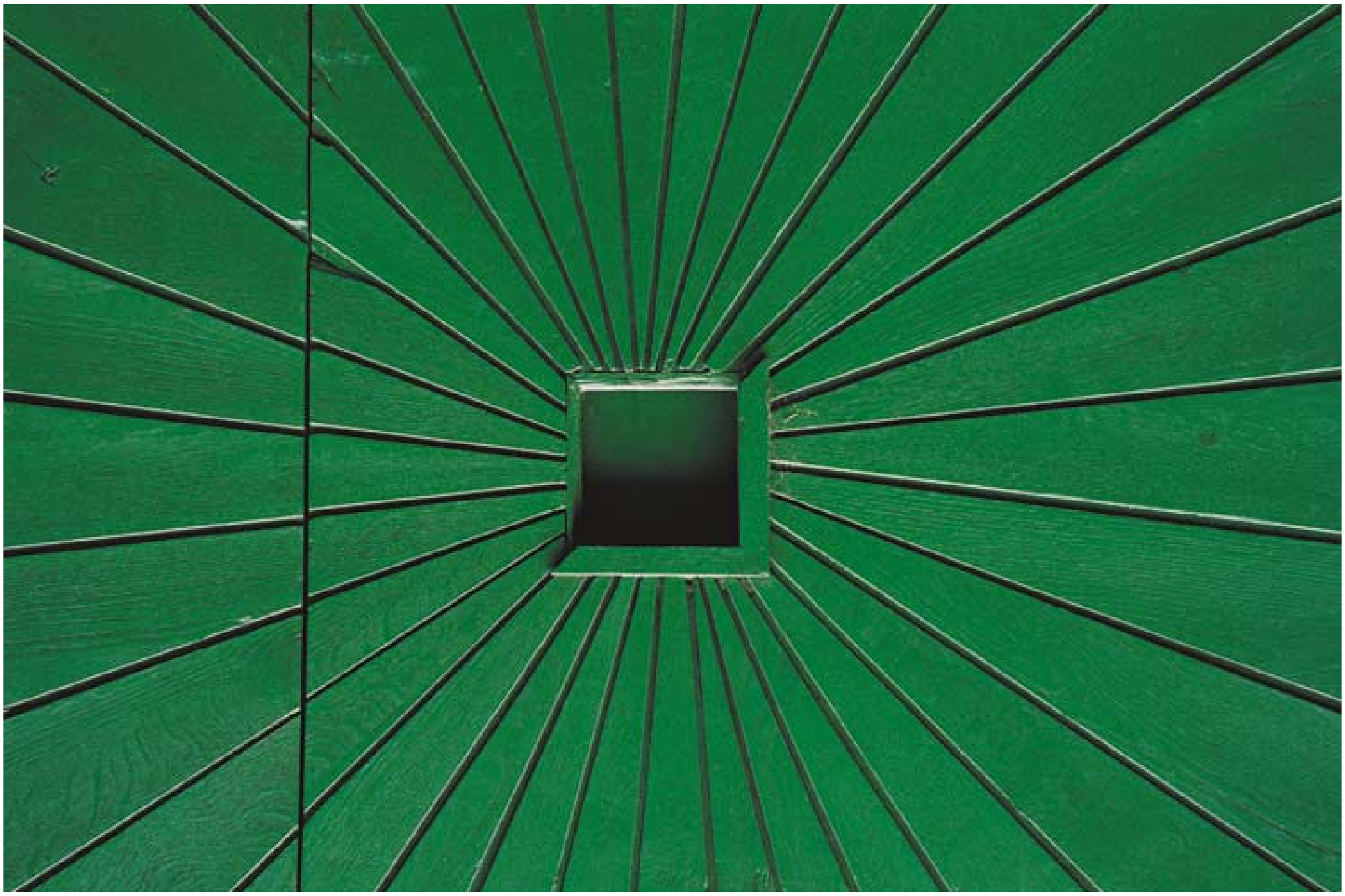
In addition, W. P. Carey provides asset management services to the $3.5 billion Corporate Property Associates (CPA®) family of funds, a series of publicly held non-traded real estate investment trusts (REITs) catering primarily to retail investors; as well as Carey Institutional Properties (CIP®), which includes institutional investors.

Recently, PricewaterhouseCoopers's Global Real Estate Leader, Nick Cammarano and partner Tim Conlon sat down with Wm. Polk Carey and Edward V. LaPuma, Executive Director and President of CIP®, to talk about the evolution of the firm, their perspective of what the future may hold and their efforts to introduce net lease financing to the global market.

**PwC:** *As a leader in net lease financing and one of the largest owners of net leased corporate real estate in the U.S., how do you plan to replicate your success in Europe?*

**WPC:** We currently have more than a couple hundred million dollars already invested throughout Europe, but we're looking to invest more, eventually billions. Our international company, W. P. Carey & Co. International LLC, which is partially owned by the public company, buys properties for the public company's family of funds. These deals are done through a cooperation agreement with W. P. Carey & Co. LLC, which is like a franchise agreement where both entities share the fees and generate the management fees.

**ELP:** As Bill said, we're committed to making a significant push in the global market this year. There have been a number of exciting innovations in the U.S. market in recent years in terms of financial engineering and technologies that we would like to implement in the European marketplace. As the largest provider of sale-leaseback financing to Corporate America, we have substantial discretionary capital funds that we are currently seeking to invest in Europe. By helping European companies realize the benefits of net lease financing we expect to replicate our current success in the U.S. in the global marketplace.



**PwC:** *What is your reasoning behind entering the European marketplace?*

**WPC:** While the U.S. market remains incredibly strong, there are opportunities in Europe where our domestic company can successfully utilize a significant amount of our capital resources. The global climate is much more favorable globally than it was in 1964, when I merged my international finance business into what is now Merrill Lynch.

**PwC:** *Can you tell us some of the countries that you're doing deals in?*

**ELP:** We're looking at deals throughout Europe. Recently we completed a $25 million long-term sale-leaseback transaction with PerkinElmer on a research and production facility in Turku, Finland. It's a beautiful facility located in Finland's leading center for technology and biotechnology-related R&D and production. We also completed a similar transaction with Nexpak, one of the world's largest media packaging companies, for a key Dutch manufacturing facility in Helmond, Netherlands.

**PwC:** *When you do your risk analysis work — obviously you have country risks, political risks, currency risks, business risks…*

**ELP:** You certainly encounter more additional risks in the global market than you traditionally do in the U.S.

**PwC:** *Exactly. And obviously you have to take that into consideration when you look at return, because you have to be compensated for additional risk if it is perceived. But how do you go about getting information to make those kinds of decisions?*

**WPC:** Dr. Larry Klein, a Nobel Laureate in Economics and one of the foremost international economists, is a member of our Investment Committee. He helped develop the Wharton econometric model for the United States and is an honorary Chairman at Penn's Institute for Economic Research. So we have access to plenty of international economists who can help us understand the risk and we won't invest in country unless we have those risks covered. Simply put, the Investment Committee must approve the investment and the terms of the transaction.

**ELP:** What you're really talking about is two additional risks, relative to what we do here in the U.S. — political/governmental and legal. To some extent there is also the tax risk, but we usually consider that legal. So from our standpoint, in your typical U.S. deal, you have two principals negotiating the deal — W. P. Carey as the capital supplier and our tenant client as the beneficiary. When you invest in the international market, you have two additional principals that are government-related and they end up being a major influence in what you get out of the transaction versus what you expected to get out of it. We rely on Larry and the Investment Committee as well as the people on the ground that we hire. We hire the very best law firms and tax counselors and accounting firms that we can, which makes our job that much easier.

**PwC:** *What about some of the other factors — issues like population growth, job growth — the kind of economic information that goes into where the plant is, or where the facility is?*

**ELP:** It's interesting. Sale-leaseback transactions are very different because when you're signing up a 20-year lease, the bulk of your total return comes from the cash flows over time. Our primary responsibility is to make sure that the tenant will be able to continue to pay the rental obligation throughout the term of the lease. In that case, the residual value of the real estate is a small percentage of the total return. So, from our perspective, the risk is not whether or not a particular small town is going to grow to become a big town. What often happens is that corporations — especially smaller corporations like the ones we deal with — will locate outside of the city instead of downtown because the rent is substantially lower. But 20 years later you find yourself owning the property that's in the center of it all because of the growth pattern. So it is an entirely different real estate transaction than one based upon the speculative growth of any particular market.

The perfect example is our recent PerkinElmer deal. You might ask why in Turku and not Helsinki? Because a substantial portion of the university students studying life sciences and biochemistry are studying in Turku. The PerkinElmer division that is in Turku is a life sciences division that is responsible for creating the bulk of the world's equipment for drug and neonatal testing. So why did they locate there? Because that is where the young, brilliant minds are, who are going to be working with PerkinElmer in creating this technology. So would you pick Turku as your first choice in terms of building a large office/R&D facility? Not unless you want to be in the life

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sciences business. But they also located right in the center of where the Finnish government is now building a huge life sciences park. So does that make sense? In our business, that makes a lot of sense.

**PwC:** *What would you say is the underlying philosophy that guides your approach to investing?*

**WPC:** We think for a large percentage of the population, a good portion of their portfolio should be in a "stay rich" investment. This emerged originally from a concept that called for a 50-50-diversification split between stocks and bonds. That evolved into a slightly more sophisticated model where you invest your age as a percentage of your "stay rich" investments. The idea is that you take less risk as you get older — when you are 30 years old, you put 30 percent of your assets in "stay rich" investments and 70 percent in "get rich" investments. When you're 70 years old, you reverse that. The reason for that is if you lose everything when you're 30, you can make it all over again. When you lose it all when you're 70, it's a hell of a lot harder. So peoples' risk profiles change. We decided to stick with this type of investing and it's proven very successful.

**PwC:** *I'm sure the investment bankers would tell you that you're underleveraged.*

**WPC:** They just think we're crazy. But I was born in 1930 and I remember the Depression and the hard times. This is an investment to protect peoples' wealth and also to provide reasonable safety and security for our employees. The way we did that originally was by combining transaction-related income and income from asset management for the parent company. In the asset management aspect, our asset management fees would cover the main overhead of the company so that if the transaction didn't work out, we would still be able to survive. This has worked out very well for the firm.

We're the largest in the world in terms of net lease financing. We also have an extraordinarily safe capital structure. The W. P. Carey Group has over $1.5 billion in equity, yet we have less than $150 million in company level debt. I don't think you could name a financial institution in

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the world that has that kind of ratio. Usually it's the other way around — they have debt to equity of 100 to one, while we have less than one to 10.

**PwC:** *You said you are the largest firm of your kind. When you benchmark yourself against the competition, against whom do you benchmark?*

**ELP:** That's actually a very good question. The reality is that competition for us is unusual. Most of the other players out there — the large credit companies and such — play in the investment grade arena. While we do transactions in the investment grade arena, our primary business is providing capital to the lower investment grade/sub-investment grade and private company market. We see beauty where others don't.

Part of the reason we have been able to carve out such a niche for ourselves is because Bill recruited people like George Stoddard, who was the former Head of the Direct Placement Department of the Equitable Life Assurance Society of the U.S. and other members of the Investment Committee — Frank Hoenemeyer, was the former Vice-Chairman and Chief Investment Officer of Prudential Insurance, Nat Coolidge, was the former Head of the Bond and Corporate Finance at John Hancock Mutual Life Insurance and Larry Klein, a Nobel prize winning economist. Our Investment Committee has more than 170 years of combined investment and real estate experience. So when younger people like myself, go to present the transactions, these guys who have seen it all before will say: "Did you think about this? Or maybe you should think about this other aspect." So because of that expertise, we have little competition in the "seeing beauty where others don't" arena.

**WPC:** A lot of people like to buy the obvious, but we like to buy the not so obvious. Dun & Bradstreet, in writing us up a few years ago, said initially we tended to have about one-third investment grade in our portfolio, one-third unrated and one-third less than investment grade. But several years later, that same portfolio would be about two-thirds investment grade.

**PwC:** *And of course you get commensurate returns — or slightly better returns than investment grade.*

**ELP:** We get significantly higher returns because we have the opportunity to work with our tenant clients to help them achieve their objectives. It's a partnership. In the end the deal doesn't get consummated unless the tenant client is happy and our investors are happy. As a firm with entirely discretionary money, which is key to being a principal, we want to make sure we satisfy our investors and meet their expectations while at the same time serving our tenant clients.

**PwC:** *That's part of your "stay rich" theory.*

**WPC:** Indeed, part of where our "stay rich" philosophy comes from is the idea of broad diversification. For example, in the early 1990s, we did a large transaction with Marriott, but George Stoddard had us lay off 50 percent of it to several pension funds, led by the General Motors pension fund. We had the cash and the ability to do the whole deal, but he thought it was too much — even though Marriott is a company he had practically nourished from childhood and he was as close to Marriott as anyone could be. George also decided to include a number of covenants in the deal which none of the other alternative investors thought of including. Later, when they went to split up Marriott into different entities, W. P. Carey had these covenants, so they had to come to us to get permission to do the deal — which we gave, under certain circumstances that were favorable to our investors. So diversification is important. The point is — no matter how good the deal is, or how strong the credit is — you don't put all your eggs in any one basket.

**PwC:** *Obviously you think this investment committee is a very unique feature of your business. Could you spend a few minutes and describe why you set that up and how it functions?*

**WPC:** Basically, I set it up because I'm a deal man, and I wanted to protect myself against myself. Also, when we hired George from Equitable in 1978, he was taking early retirement and was getting a number of offers from other firms on Wall Street. He has an extraordinarily great mind and he's joined by Frank Hoenemeyer, Nat Coolidge, Larry Klein and most recently Ralph Verni. Ralph had been Chief Investment Officer at New England Mutual and President and Chief Executive Officer at State Street, which is Metropolitan Life's investment management arm. He's been a terrific addition and we're very lucky to have him.

**PwC:** *Now, does that committee sit over the W. P. Carey entity?*

**ELP:** Every single transaction we consider must be unanimously approved by our Investment Committee.

**WPC:** They also handle the allocation, so they put it in the funds they think is appropriate as fiduciaries. A lot of their decisions have to do with diversification. They don't want too much of any one fund or any one type of deal. They can split the deals between one fund and another, but all things being equal, the money usually goes to the fund that has had the most cash for the longest time.

**PwC:** *Could you talk a little about how your firm is organized? You have this series of private REITs and you have the holding company above them and you also have a private company as well. So there are three basic pieces. Is there a way to explain how an investor invests in W. P. Carey relative to that structure?*

**WPC:** There are two ways of investing in W. P. Carey. One is through the public company, W. P. Carey, which is the largest publicly traded limited liability company listed on the New York Stock Exchange. That's a terrific vehicle for taxable investors. It provides a combination of real estate investment and investment management business. It's more of a real estate investment than our private REITs because it consists of our Corporate Property Associates One through Nine, which were partnerships. They were started a long time ago and their leases are expiring all the time. Each year some more expire, so you're always going back into the real estate business, but it's also an investment management business so the balance is terrific. The investment management business tends to go up pretty steadily. When you're managing private REITs, you don't get a lot of ups and downs like you do when you're managing public REITs. One of the leading public REIT managers reported that assets under management went from $4.6 billion to $2.6 billion in about three months. That's pretty volatile. Whereas, at the same time with our private REITs, the assets under management kept going up. So the assets under management provides a nice stable balance for the real estate business.

**PwC:** *That's W. P. Carey.*

**WPC:** Yes, that's W. P. Carey.

**ELP:** Bill once gave a very good description of W. P. Carey — as a rocket ship with a management business attached to a freight train, which is the original real estate assets.

**WPC:** That's right. A rocket ship attached to a freight train; that's what we call it. And it's a mixture — of very safe things and very exciting, growth opportunities. The private REITs are very suitable for pension funds and retail investors.

**PwC:** *This is the second way to invest.*

**WPC:** Yes, that's the second way to invest. The CPA® family of funds are publicly held non-traded REITs. Companies that don't want to trade, but want to invest in a solid, rising income vehicle for a pension plan really can't do much better. As a pension fund, if you want to go out and leverage a piece of net lease real estate, you're going to be subject to unrelated business income tax — but not if you invest in a REIT. So you've got the best of both worlds. There's no real reason not to leverage net lease real estate — it just increases your safety because it increases your diversification broadly. It's always non-recourse debt, and there is no cross-collateralization. Every deal is set up as a stand-alone.

**PwC:** *What kind of returns can an investor expect from your REITs?*

**ELP:** The total returns investors have received has been in excess of 12 percent over time. Historically, on a total return basis, if you look at the liquidation of the original nine portfolios, the average investor received in excess of a 12 percent return over their hold period, which is pretty spectacular when you consider that the average return historically in the equity markets is somewhere in the 11 to 12 percent range.

**WPC:** Plus we had some tax benefits, so investors were able to defer a significant portion of their income because we used depreciation and received the benefit of the leverage. The taxable total yield is significantly higher than they would be able to get in other investments.

**PwC:** *How do you diversify your investments?*

**WPC:** We feel diversification is important. We diversify by industry, geography, and property type.

**ELP:** We have two separate and distinct constituencies. One is the tenant client — the people we go out and actually provide the funds to or transact the sale-leaseback with. And the second is our investors. Now, if we were pitching to our investors and telling them our story, a major focus would be the way Bill has organized the company as an absolute fiduciary. That is the role of the Investment Committee — they don't get paid on profit, they don't get paid on number of transactions or total volume. They are paid to essentially tell us: "No."

**PwC:** *Just so our readers understand the structure — you have W. P. Carey, and you have these series of private REITs. The relationship there is one of…*

**ELP:** A managerial and contractual relationship.

**PwC:** *So those are the two avenues to invest — either through the private REITs or through the public company.*

**WPC:** Most of the new opportunities, as a practical matter — are not offered to the public company, the manager, because of the obvious conflicts. We do not want to have a situation where someone is accusing us of taking the best deals and leaving the not-as-nice deals for the private REITs. If it's suitable for the private REITs, that's where it goes. We have never had any properties kept back for ourselves, although a lot of firms will do that. There hasn't been one deal in almost 30 years of business that has been taken personally, for us, as opposed to our clients. We've never permitted it.

**PwC:** *Now at W. P. Carey, the public entity, what is the split in the income between the management of the funds and the rent generation?*

**WPC:** It's close to 50-50. But the management side is increasing.

**PwC:** *So W. P. Carey has been in business now for almost 30 years. Obviously you've been successful. If you have to look 10 years out, where do you see the company then — basically doing the same thing? Expanding a little differently? Or will you stay the course?*

**WPC:** Well, I'm 71 years of age, so I'm not the one to address that. But what we have done is basically set this company up with some absolutely brilliant and talented young people. In the firm, Ed is prepared to oversee the global operations and Gordon DuGan, our President and Chief Acquisitions Officer is prepared to run the domestic company. Ed is 29, Gordon is 34 and John Park, our Chief Financial Officer, is 36. So we're pretty well positioned for the next move.

We are also extraordinarily well capitalized and we have a great group of people under them. We probably look at 100 people for every one that we hire and those 100 all look pretty good on paper. But it's a very, very highly selective process and we're able to attract many good, young people.

**PwC:** *So generally speaking, a young management team to carry you forward, but basically, still doing the same thing?*

**WPC:** The net lease business is our core business, the one in which we're the leaders. I don't think there is any question that we can be number one everywhere, but I think Ed is capable of taking us to great heights in the international business arena.

Eventually other products will come along. For example, we have people who are interested in things like direct equity private placement, venture capital and other types of direct investment besides net lease financing. There are also other types of private placements which we could easily go into, because we have the in-house capability to do that, but I won't be making those decisions.

Ed, Gordon and others will be taking us to the new heights and I'll be sitting back and enjoying it. I intend to remain as Chairman, incidentally, for the foreseeable future but in a less hands-on fashion. I want to spend more time helping with the international side because I have a solid feel for it, having been in the business as a young man, and I enjoy it. It's a lot of work, but it's fun, it's partially recreational for me. I also want to do more with the not-for-profit activities of the W. P. Carey Foundation, which takes a lot of my time now and will probably take more down the road. For example, we have a W. P. Carey minor at Johns Hopkins University, which has become the most popular minor at the university. That helps us to recruit some very good people. We're also doing a lot with Penn in the economics research area. For example, we're trying to set up an economics research institute in India with one of Larry Klein's Ph.D. students, who was head of the reserve bank of India and is governor of one of the major states. To have people like that involved, you're doing good. Your primary interest is seeing that they get the best kind of foreign direct investment for them, to create prosperity and jobs in their country. We can help by being there with some money, too. I've always believed in, "doing good, while doing well."

**PwC:** *Thank you both.*