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REAL ESTATE INVESTMENT TODAY
JANUARY/FEBRUARY 2018

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# CorEnergy Fuels Change

BY DAWN WOTAPKA

Kansas City-based **CorEnergy Infrastructure Trust, Inc.** (NYSE: CORR) specializes in real estate assets that perform utility-like functions, such as pipelines, storage tanks and terminals for moving oil and gas. The pioneer in energy-related infrastructure real estate converted to a REIT in 2013. With market cap of about $450 million, the company has big intentions to grow in an area that has long been typically funded by master limited partnerships (MLPs) and municipal or government bonds.

Infrastructure real estate, by its nature, is usually critical to the tenants' business models. It would be too complicated and expensive to build from scratch, so they sign long-term leases of a decade or more that are likely to be renewed. Indeed, CorEnergy's properties would be nearly impossible to replicate, given the cost of construction, the increased value of land, strong power of NIMBYs—particularly on social media—and the ability for a single lawsuit to stall projects indefinitely.

"The energy-infrastructure market has less competitive dynamics at play. There typically aren't speculative pipelines built. There's less vacancy-rate risk," says CEO David J. Schulte, whose achievements include earning a law degree from the University of Iowa, studying for the CFA exam, spending time as an investment banker and co-founding a family of closed-end funds. "These are the hallmarks of things that are attractive to REIT investors."

## AT A GLANCE

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The Pinedale Liquids Gathering System includes 150 miles of Wyoming pipeline that is considered critical to the nation's sixth-largest gas field.

## NOVEL BEGINNING

What is now CorEnergy was actually started in 2007, just as the financial crisis was roiling the globe. "That's a novel beginning alone," Schulte notes.

At that time, it was an investment strategy of Tortoise Capital Advisors LLC, an energy-focused investment vehicle with about $16 billion in assets. It was operated as a closed-end BDC, or a business development company, focused on energy-related infrastructure real estate.

Arcane government regulations required such funds to be valued quarterly. This posed a problem for Tortoise after the financial crisis, given that asset values had plunged. Meanwhile, funding from lenders dried up. The company decided to "pivot," Schulte recalls.

The idea of energy-related real estate assets qualifying as a REIT was "little known at the time," according to the CEO. "No one had done it yet."

Portland Terminal Facility is a sprawling 39-acre rail and marine transloading terminal, a key link in supply chains.

Becoming the first such REIT worked, but while many real estate companies have enjoyed the bull run of the last few years, the soft energy market from 2014 to 2016 took a toll on CorEnergy. Tenants Ultra Petroleum and Energy XXI separately filed Chapter 11 bankruptcy, making CorEnergy investors jittery and weighing on the stock until the companies revamped and reemerged in 2016 and 2017. The silver lining: "Management successfully proved its business model in 2016 and 2017," says Selman Akyol, an analyst with Stifel Nicolaus who covers CorEnergy.

During the period, Schulte points out that CorEnergy "didn't miss a rent payment, and our dividends were stable. Underwriting was good."

## OIL CORRELATION

Barry Oxford, a veteran REIT analyst with D.A. Davidson Cos., says he was skeptical of the business model when he first began covering CorEnergy in 2017. However, Oxford soon realized the business plan was similar to any triple-net lease real estate operator.

"The widget is just a pipeline," he says. "I really like what they're doing. It's very unique, but I think it's a good play on the oil sector."

The REIT transition for CorEnergy preceded the oil market's softening, which pushed two tenants into bankruptcy and weighed on the company's stock. Yet, after plunging to below $12 per share in early 2016, the stock had tripled in value toward the end of 2017. Meanwhile, the basic FFO for the nine months ended Sept. 30 came in at $3.07 per share, up nearly 10 percent from the prior year. As such, the REIT model demonstrated stability in cash flows through the commodity downturn, according to Schulte.

CorEnergy expects its rental income to continue climbing,

The MoGas Pipeline System is a 263-mile interstate gas pipeline system that connects the St. Louis region with western Illinois and central Missouri.

according to financial filings. In 2018, it anticipates minimal rental income of nearly $61.4 million, a figure that could jump about 25 percent by 2021, based on the current portfolio.

Oxford thinks that once CorEnergy's model is better understood, the stock's performance will stop mirroring the price of oil. It "should be more correlated with its earnings," he says. "My thesis is that over time, the volatility in their stock price should start to shrink as more people realize what CorEnergy is about."

## TIME TO GROW

CorEnergy has been vocal about wanting to begin growing soon by doing one to two transactions with a target range between $50 million and $250 million each per year. Lower commodity prices may actually benefit CorEnergy as a purchaser because regulatory constraints have left banks reluctant to lend to oil and gas producers, a drag for companies with capital expenditure plans.

"We provide a differentiated source of capital," Schulte says. "They can sell us their lower-returning-but-necessary assets" and lease them back, freeing up capital to be deployed in higher-returning projects.

According to financial filings, acquisitions will "enhance the stability of its operations, reducing the risk to existing to shareholders." Indeed, one empty property would cause the vacancy rate to spike.

Oxford said he would have like to have seen an acquisition by now, but he understands the types of purchases that the company is trying to make are "much more involved and, my guess is, the due diligence on CorEnergy's part is much more involved." Once a deal happens, that will drive the company's earnings and their growth rate, according Oxford.

Now that CorEnergy has done the heavy lifting in terms of creating an energy-related infrastructure REIT, competitors will likely begin to emerge. Unlike the sectors with minimal barriers to entry that are brimming with players, though, there will never be an overabundance of energy-related infrastructure REITs. For now, Schulte sees plenty of potential for CorEnergy with the billions of dollars in energy assets that could be purchased and leased back.

"We've barely scratched the surface," he says of the sector's potential. "I think it's a very large opportunity." ■

Omega Pipeline Co. owns a 70-mile pipeline system for natural gas distribution, serving south-central Missouri including a U.S. Army base under a long-term contract.

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*– David J. Schulte, CEO, CorEnergy Infrastructure Trust*

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