What Caused Dream Office REIT to Decline 30%?

Description

Usually, when investors see high yields, such as the 8.4% offered by **Dream Office REIT** (TSX:D.UN), they immediately think it's high risk, and avoid it.

Come to think of it, savings accounts offer interest rates of around 1%; GICs offer around 2%; and the **iShares S&P/TSX 60 Index Fund** offers 2.6%. So, what is the risk that comes with receiving Dream Office's high income of 8.4%?

First, let's take a look at Dream Office's tenants.

Dream Office and its tenants

Dream Office REIT is Canada's largest pure-play office REIT. Of its hard-to-replicate 24.2 million square feet of office properties, 7.4 million square feet is occupied by tenants including municipal, provincial, and federal governments as well as a diverse range of high-quality large international corporations, including Canada's major banks, three of Canada's prominent law firms, and small- to medium-sized businesses across Canada.

With over 2,200 tenants, Dream Office's risk of exposure to any single large lease or tenant is mitigated. Also, 17.5% of its total rental revenue comes from the government and government agencies that provide stable and quality cash flows to Dream Office.

Dream Office's net operating income is diversified as follows:

Dream Office REIT NOI
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Source: Dream Office REIT Financial Report – Q1 Report

Main concern: expiring leases

It seems Dream Office has a diversified geographic and tenant mix. Then what has caused its price to decline from 2013's $39 per unit to today's $27, a drop of 30%?

The main concern is that lease terms are approaching expiration. Dream Office REIT's average remaining lease term at the end of March 2015 is 4.9 years. Its western Canada and Calgary-suburban portfolios' lease terms are expiring the soonest, with average remaining lease terms of 3.6 years.

Dream Office is making efforts to retain its tenants in lease renewals. In the first quarter of 2015 it had already secured 73% of its 2015 lease expiries, made good progress in addressing 2016 expiries, and had proactively engaged tenants in early renewal discussions.

Additionally, for the last several quarters Dream Office has further advanced collaboration between its leasing and property management teams to build on tenant satisfaction to address a more difficult operating environment.

These efforts are reflected in its portfolio-wide occupancy, which continues to be well above the national average.

Is the 8.4% yield safe?

With a payout ratio of 78%, Dream Office REIT's monthly distribution of an annual 8.4% yield is safe. I believe the risk-reward ratio is in investors' favour, with the price below $27. However, conservative investors could wait until 2016 when more lease renewals are expected to be confirmed.

Further, the REIT believes its net asset value indicates the unit price of $32.53, meaning that the units are priced at over 17% discount below $27.

Dream Office REIT could be a nice turnaround stock for the next two years.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)

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Date
2025/08/23
Date Created
2015/05/26
Author
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