Dream Office Real Estate Investment Trust: Can You Count on This 9.5% Yielder?

Description

Investors looking to supercharge their income don't have to look much farther than **Dream Office Real Estate Investment Trust** (TSX:D.UN) and its 9.5% yield.

Naturally, some investors are a little concerned about a yield that high. Many have a rule that anything above 5% is automatically a giant red flag, and should be avoided at all costs. Most are content to take a yield of 3-4%, as long as it's steadily growing.

But for many investors, an average yield just isn't good enough. They're looking for more, either in an attempt to supercharge their income or as an indirect value play. If a stock with a huge dividend can maintain the payout, chances are shares will head higher over time.

Is Dream Office REIT such a company? Or is the dividend about to get slashed? Let's take a closer look.

Solid earnings

At least on the surface, Dream's payout looks to be sustainable.

In 2014 the company earned $2.88 per share in funds from operations, which is a standard metric for profitability in the REIT rector. Its dividend payout was $2.23 per share, giving it a payout ratio of 77.5%. That's right around average for the sector.

Even in the first quarter of 2015 the company reported solid results. Funds from operations came in at $0.71 per share for the quarter, which works out to $2.84 per share annualized. The company also expects results to tick up a bit in subsequent quarters, since it picked up a major tenant in Calgary during the quarter.

From those results, the dividend looks to be pretty sustainable. So what gives? Why are investors so concerned?

There are a couple of reasons. Firstly, the downtown office market in Calgary is looking weak, as energy companies slash office expenses in order to cut costs. No energy company is going to expand its footprint in this type of environment.

Both the Toronto and Calgary suburban markets aren't looking good either. Toronto's market is being rocked with new supply, while Calgary's weakness is mostly related to the slowdown in energy. Both of those issues are causing investors to get nervous and sell their shares.

A decent value

One thing I like to do when looking at high yielders is to pretend the dividend doesn't even exist. I need a compelling reason besides the dividend to buy shares.

Dream Office has a couple of things going for it I like. The biggest one is the company's moat, which is in the form of some terrific buildings in the core of some of Canada's largest cities. These buildings will always be in demand because of access to transit and because tenants want the prestige of having an office downtown. There's an argument to be made that the suburban buildings aren't great, but overall I like Dream's portfolio.

The other thing Dream has going for it is the valuation. Currently, the company has a book value of $35 per share. At just over $23 per share, investors are buying a portfolio of properties at more than 30% less than what they're worth.

Dream is also giving back to shareholders in a different way, one that's a little odd in the REIT world. Management is convinced shares are undervalued, so they're buying back shares. The company isn't making a huge dent because it has committed most of its earnings to dividends, but it's still a nice move.

Finally, Dream has recently made another move that investors should be cheering. Its management team officially moved in house, meaning all they'll focus on is Dream's office portfolio, instead of splitting time among the rest of the assets in the Dream family. That bodes well for the future.

As it stands right now, investors can count on Dream's dividend. And if the dividend isn't enough, investors can take comfort in knowing Dream owns good assets that are currently on sale at a discount. It's good enough for my portfolio, anyway.

CATEGORY

1. Dividend Stocks
2. Investing

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

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