



## Are These Office REITs' 10%+ Yields Safe?

### Description

There are many reasons to buy real estate investment trusts (REITs). One reason is that you don't need to manage any properties or seek new tenants when your old one leaves. In the REIT world, some REITs are especially known for their juicy yields. In fact, there are two office REITs that yield over 10% today.

#### Dream Office REIT

**Dream Office Real Estate Investment Trust** ([TSX:D.UN](#)) is Canada's largest pure-play office REIT. It owns over 24 million square feet of gross leasable area across 34 cities and 2,200 tenants.

Eighty-four per cent of its net operating income (NOI) comes from core Canadian markets such as the Greater Toronto Area, Calgary, Edmonton, Vancouver, Montreal, and Ottawa, and 71% comes from central business districts.

According to reports by CBRE, a publication prepared by a commercial firm that provides information relating to the real estate industry, Dream Office REIT has historically maintained higher occupancy rates than the national office occupancy rate by 3-4%.

For example, in the second quarter CBRE reported that Dream Office REIT maintained an occupancy rate of 92.8%, higher than the national office occupancy rate of 88.6% in the same period.

Perhaps what worries investors is that the REIT's average remaining lease term is 4.8 years. Dream Office's price has declined from a 2012 high of \$39 to today's \$21.3, a steady fall of 45%.

Dream Office REIT reassures investors that over the next five years larger tenants with over 100,000 square feet leases will represent only 4% of expiries per year (equivalent to less than five tenants).

Dream Office REIT had roughly 300 leases completed last year. Additionally, the Dream Office leasing team typically completes between 2.5-3 million square feet per year.

With the three-year fall in price, Dream Office now yields 10.5%. Based on its adjusted funds from

operations (AFFO), its payout ratio of 95% leaves little room for error.

## **Slate Office REIT**

**Slate Office REIT** (TSX:SOT.UN) focuses on accumulating non-core office properties in major office markets for its portfolio. These non-core properties are overlooked by large investors, so the Slate management believes greater value can be mined versus going for trophy assets.

Slate Office is a smaller REIT with a market cap of only 220.5 million compared with Dream Office's market cap of 2.3 billion. That's why it's all the more important that insiders own a big piece of it. Indeed, management has aligned interests with unitholders. Slate Asset Management L.P. owns roughly 20% of the REIT.

Slate management has experience creating value in the office sector. Specifically, in 2005 to 2011 it co-invested and managed Blackstone's \$865 million Canadian office portfolio. For that portfolio, it increased NOI by roughly 300% and achieved an impressive 30% rate of return.

At the end of the third quarter, Slate Office owned 5.3 million square feet of space over 48 properties. Its top 10 tenants contributed to 43% of base rent and have an average of 6.5 years of lease terms remaining. These tenants include **BCE Inc.**, the Government of Canada, and the governments of Manitoba and New Brunswick.

One thing to note is that 30% of portfolio square footage expires in the next 2.5 years. However, the REIT sees this as an opportunity to grow its rental rate.

Slate Office costs \$7.21 per unit and yields 10.4%. Based on its AFFO, its payout ratio of 81% gives some margin of safety for its high yield.

## **So...are their 10%+ yields safe?**

Dream Office's rental rates are below market, which might mean it's competing by price. However, its payout ratio has been lowered from 99% in 2008 to 95% by June 2015. So, its juicy yield of 10.5% is sustainable for now.

Slate Office's payout ratio is 81%, and with quality tenants paying 43% of its rent, its 10.4% yield is pretty safe. Cautious investors should watch for how it executes the rollover of its 30% lease expiries in the next 2.5 years before deciding on an investment. After all, there's little history on the REIT's execution given it only had its initial public offering on December 28, 2012.

REITs pay out distributions that are unlike dividends. If you wish to avoid the tax-reporting hassle, you should purchase REITs in TFSAs or RRSPs.

## **CATEGORY**

1. Dividend Stocks
2. Investing

## **TICKERS GLOBAL**

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

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