



Yield Alert: 12.5% at Dream Office Real Estate Investment Trst

Description

At first glance, **Dream Office Real Estate Investment Trst** ([TSX:D.UN](#)) looks, well, dreamy.

The company pays a distribution that offers investors a 12.5% yield, and many followers of the name believe the payout is sustainable.

For the next few quarters, that is probably the case, but things are a bit less certain in the coming years, and the market seems to be cluing in.

Alberta's woes

Dream Office REIT has more than 24 million square feet of office space available for lease in Canada.

The portfolio is spread out across 176 properties with an average occupancy rate of 93%. That looks like a pretty safe bet, but there are some concerns with a significant part of the portfolio.

Alberta represents 26% of Dream Office REIT's net operating income. Calgary alone accounts for 18%. Edmonton represents 8%.

Oil companies are downsizing in an effort to reduce costs and remain solvent as oil prices continue to linger near multi-year lows. What started as a short-term plunge in oil and gas prices is now looking like a new normal for the industry.

That isn't good news for owners of office towers in Calgary.

Many of the buildings already have empty floors, and energy companies are sub-leasing the space for as low as 50% below the original contract.

As lease agreements come up for renewal, building owners are going to be looking at significantly lower rates going forward.

According to its latest investor presentation, Dream Office REIT says 10.2% of its total leasable area, or about 2.5 million square feet of space, will come up for renewal in Calgary and Edmonton in the next

three years. Dream Office REIT has 2.7 million square feet of space in Calgary, so a large part of the leases will expire in the next few years.

Space that is already vacated by oil and gas companies probably won't be renewed and non-energy clients are going to want a steep discount when their leases come up.

To make matters worse, there are five brand new office towers under construction in Calgary right now that will add an additional two million square feet of office space to the market in the next three years.

Reliance on Toronto

The core focus of Dream Office REIT's portfolio is found in the GTA where economic conditions are still stable and demand for office space in the downtown core is quite strong.

The hallmark asset is Scotia Plaza, which is 60% leased by one tenant, **Bank of Nova Scotia**. The building alone accounts for 15% of Dream Office REIT's total net operating income.

The company has a total of 26 downtown Toronto properties, which contribute 30% of the total operating income. That portfolio is probably safe, but it might not be strong enough to carry potential troubles across the other 150 properties in the event of a broader economic slowdown.

Debt costs

Dream Office REIT has an average maturity of 3.9 years on its \$3.1 billion in debt. Interest rates are expected to rise in the coming years, so the company might have to pay more just when revenues are likely to fall.

Is the distribution safe?

Mr. Market is rarely wrong. The stock is down nearly 30% this year and still hitting new 12-month lows.

The distribution might survive, but investors should be very careful chasing this 12.5% yield, especially if the broader Canadian economy starts to fall out of bed.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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