



## Dream Office Real Estate Investment Trst: Ignore the 12.7% Dividend

### Description

There are a lot of investors attracted to **Dream Office Real Estate Investment Trst** ([TSX:D.UN](#)) and its 12.7% yield.

Obviously, most of these are folks who want the dividend. And who can blame them? In a world where you have to lock your money into a GIC at some obscure bank for five years just to get over 2% annually, it's easy to see why investors are willing to take on risk in exchange for a much higher yield.

At first glance, Dream's dividend seems pretty sustainable. The company pays \$0.1866 per share on a monthly basis, which works out to \$2.24 annually. According to the company's latest investor presentation, analysts expect it to earn \$2.25 per share in adjusted funds from operations in 2016. That puts the payout ratio at a very high 99.6%. It'll be tight, but it looks like 2016 won't be the year Dream cuts the dividend.

In reality, the payout ratio doesn't paint the whole picture. Since so many of Dream's shareholders take their dividends in the form of additional units rather than in cash, Dream's cash payout ratio is much lower. Through the first nine months of 2015, it paid \$115.3 million in cash distributions, meaning it's on pace to pay \$153.8 million in cash out to unitholders for the whole year. If it paid every nickel of its dividend in cash, it would be on the hook for \$241.2 million annually.

Thus, Dream's cash payout ratio is approximately 64%. Admittedly, it can't keep up such an arrangement forever, since each of those newly issued shares now have to pay dividends. It creates a compounding effect that can only be solved by earnings going up. Still, it bides the company some time.

### Ignore the dividend

There's a real possibility the dividend will get cut, especially if Dream's shares continue to head lower. Over the last year, the company has lost nearly 30% of its market cap as investors shun just about every company with exposure to Calgary's office market.

Dream's management team isn't dumb. They know they have one of the biggest yields out there, and it still hasn't stopped the share price from sliding. Since it seems like the market has already assumed

the company will cut the dividend, management could decide they might as well slash it and use the cash for other purposes instead.

Investors buying Dream today have to at least prepare themselves for that possibility. Even if the company slashes the dividend by 50%—which I view as exceedingly unlikely; a 20% cut is more likely—it'll still pay a yield of nearly 7%. It'll then have millions of dollars per year to put towards debt or buying back undervalued shares.

Investors who focus on Dream's dividend are missing the real reason to buy shares at today's levels: the company is undervalued. There's an argument to be made that Dream's shares are worth close to \$30 per share, which implies a 68% upside potential from today's levels.

Remember, Dream is projected to earn \$2.25 per share in adjusted funds from operations in 2016. That puts shares at less than eight times earnings, which makes the company the cheapest REIT in Canada—at least, that I can find—and one of the cheapest companies overall.

REITs have to estimate the current value of their assets each quarter. In November, when Dream last calculated the value of its assets, management put a net asset value of \$28.44 per share on the company.

It's not like Dream's assets stink, either. Nearly 50% of its assets are office towers in downtown Calgary and Toronto. Sure, Calgary's downtown market isn't exactly booming right now, but it'll eventually recover. And in the meantime, investors are buying stakes in some of the city's largest office buildings with great locations right by public transit.

Those are the kinds of assets you want to own over the long term. Dream Office REIT is giving you the opportunity to buy them for 60 cents on the dollar. It's for that reason I own the stock; the dividend is just a nice bonus. Thus, I won't get too excited if it does get cut, and neither should other investors.

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1. Dividend Stocks
2. Investing

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1. Editor's Choice

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

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**Date**

2025/09/12

**Date Created**

2015/12/22

**Author**

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