Want a High Yield? 2 Things to Watch for in Dream Office Real Estate Investment Trst

Description

Real estate investment trusts (REITs) offer some of the highest yields as distributions. They own, operate, and manage diversified portfolios of property assets.

Using **Dream Office Real Estate Investment Trst** (TSX:D.UN) as an example, there are a couple things investors should watch for.

Is the yield sustainable?

High yields must be paid from somewhere. REITs' distributions are paid out from funds from operations (FFO), which is comparable to firms that pay dividends from earnings.

Dream Office is an office REIT that earns 85% of its net operating income from key Canadian markets, including the Greater Toronto Area, Calgary, Edmonton, Vancouver, Montreal, and Ottawa.

At about $19 per unit, it yields 7.9%. Its monthly distribution is 12.5 cents per unit, equating to an annual payout of $1.50 per unit. So, if you buy 100 units for about $1,900 (excluding trading fees), you can generate $150 per year.

Dream Office's FFO payout ratio is about 56%, which gives it a margin of safety for its distribution. However, the company is in the midst of selling off $1.2 billion of its non-core assets. In early May $212 million in assets were sold, $123 million were confirmed, and about $200 million of assets were in the selling queue.

Dream Office plans to use the sale proceeds to strengthen its balance sheet and reduce debt. At the same time, its FFO will also decline.

Dream Office has total assets of $6.8 billion, of which the non-core assets make up 17.6%. It's more likely that core assets generate higher revenues than non-core assets. So, being conservative, let'ssay that 18% of Dream Office's FFO will be gone once it sells its non-core assets. If so, Dream Office's payout ratio will still be under 68%. So, Dream Office's 7.9% will remain sustainable.

Buy at a discount

Generally, since high-yield companies tend to have slow growth, investors should buy them at a margin of safety whenever possible. That is, investors should buy them when they're priced at a discount to offset any slow-growth periods.

Investors are in luck. Dream Office is selling at a big discount to its net asset value (NAV). At the end of the first quarter the company estimates its NAV per unit to be $30.31. At about $19 per unit, Dream Office is selling at a discount of about 36%.

Tax on the income

REITs pay out distributions that are like dividends but are taxed differently. If you wish to avoid the different tax-reporting hassle, buy REITs in TFSAs to earn tax-free monthly income.

Investors may also be interested to know that in non-registered accounts, the return of capital portion of REIT distributions is tax deferred until unitholders sell or adjusted cost basis turns negative.

Conclusion

Dream Office's FFO is expected to decline in the near term as the REIT sells its non-core assets. That said, its distribution yield will remain sustainable. Additionally, it trades at a discount of about 36% from its NAV.

So, Dream Office is a good candidate for current income and total returns. If it trades at its NAV again, we're looking at a price appreciation of about 57%, while you get a 7.9% yield to wait.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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Author
kayng