3 Reasons to Propel This REIT Higher

Description

At about $19 per unit, **Dream Office Real Estate Investment Trst** (TSX:D.UN) is trading at late 2009 levels. And there are reasons to believe that it can head higher within the next three years.

Undervalued

Dream Office is discounted based on multiple valuation metrics. The real estate investment trust (REIT) trades at 6.9 times its funds from operations (FFO), which is at the low end of its last few years' range of 6.1-13.3 times.

Additionally, Dream Office's net asset value (NAV) at the end of the first quarter was $30.31, which indicates the units are undervalued by more than 37%.

A part of the reason for Dream Office's discounted units is that the Canadian-office leasing market has been challenging, particularly in Alberta, where Dream Office earns 26% of its net operating income (NOI).

On the other hand, Dream Office earns 59% of NOI from other core markets, including British Columbia (5%), the Greater Toronto Area (45%), Montreal (5%), and Ottawa (4%).

At the end of March, Dream Office also owned 23.9% of **Dream Industrial Real Estate Invest Trst** (TSX:DIR.UN), which has a high and stable occupancy rate above 94%. Dream Office earned 5.6% of its FFO from Dream Industrial in the first quarter.

Strategic plan

In an attempt to reduce the discount between its unit price and its NAV, Dream Office started executing a strategic plan in February. The plan included revising its distribution a third lower, eliminating its distribution-reinvestment plan, and identifying $2.6 billion of non-core assets for disposition with plans to sell $1.2 billion of the properties within three years. And Dream Office's unit price has appreciated 20% since February.

After reducing its monthly distribution to 12.5 cents per share, Dream Office's payout ratio is much more conservative at about 56%. The elimination of the distribution-reinvestment plan also prevents diluting the stakes of current unitholders.

There's a big margin of safety for Dream Office's payout, but the REIT plans to use the non-core asset sale proceeds to repay debt, strengthen the balance sheet, and invest in its properties.

As the REIT sells its non-core assets and its FFO declines, its payout ratio will head higher and be more in line with its peers' payout ratio. For example, **Allied Properties Real Estate Investment's** first-quarter FFO payout ratio was less than 70%.

Normal course issuer bid

In June, Dream Office renewed its normal course issuer bid, so it can buy back up to 10% of its public float for cancellation. The REIT believes that buying back its units at the current discounted price is in the best interest of the REIT and its unitholders.

Conclusion

Dream Office is undervalued compared with its historical trading levels. Additionally, the REIT is executing a strategic plan to reduce the gap between its unit price and its NAV. Lastly, any efforts Dream Office makes in buying back its units at a discounted price for cancellation will also help push its unit price higher.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:DIR.UN (Dream Industrial REIT)

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