



## There's More to These 2 Office REITs Than Just Income

### Description

When investing in real estate investment trusts (REIT) which own, operate, and manage portfolios of real estate, the first thing that investors think of is income.

Two office REITs, **Dream Office Real Estate Investment Trst** ([TSX:D.UN](#)) and **Slate Office REIT** (TSX:SOT.UN), don't disappoint. They deliver monthly cash distributions to unitholders' accounts that equate to yields of 9.1% and 8.8%, respectively.

However, before jumping into any of them, investors should dig deeper. After all, the total return consists of both capital appreciation and dividends.

### A year's return

Looking at only a year's return is too short to be conclusive, but it can be telling, and we can learn at least a thing or two from the exercise.

If you'd invested in Dream Office REIT a year ago, your investment would have declined 27%, but you would have received an 8.2% yield. So, your annualized return would have been -18.8%.

Similarly, if you'd invested in Slate Office REIT, your investment would have appreciated 18.4%, and you would have received a 10.4% yield. So, your annualized return would have been 28.4%.

### Why is there a big difference in returns?

Choosing one investment over the other would have made a huge difference in your returns. In the last year, what made Dream Office a bad investment, and what made Slate Office a great investment? Are those factors still in play?

Alberta contributes 27% of Dream Office's net operating income (NOI). Since Alberta's economy remains weak due to low commodity prices, there has been lower demand in office space in Alberta. Dream Office's occupancy rate in Alberta declined from 88.5% in Q1 to 84.2% in Q2, while its portfolio occupancy rate was 90.1%.

In fact, due to its Albertan portfolio, Dream Office recorded a fair-value loss of \$748.4 million for the six-month period that ended on June 30, 2016. From the end of Q2 2015 to the end of Q2 this year, Dream Office saw its net asset value per unit fall almost 29% to \$23.64.

Dream Office's performance is likely to continue to be dragged down, until commodity prices recover and stay at a higher level.

Compared to Dream Office, Slate Office is a much smaller REIT. Dream Office has a market cap of \$1.8 billion, while Slate Office has a market cap of under \$300 million. Unlike Dream Office, which cut its distribution by a third during the year, Slate Office has maintained its distribution so far.

Since Slate Office is much smaller in size, it has higher growth potential when acquiring additional assets. However, acquisitions have their own risks as well, and management execution is of the utmost importance.

Slate Office's recent acquisition announcements included an \$85 million investment in both June and August. Both investments were across multiple properties.

Slate Office funded these acquisitions with a combination of debt and equity through secondary offerings. After the secondary offering for the August acquisitions, the Slate management still owns about 15.3% of the outstanding units on a diluted basis. So, management's interests are aligned with unitholders'.

Slate Office also employs a different strategy than Dream Office. Slate Office focuses on high-quality, non-trophy downtown and suburban office properties, which are often overlooked by large investors and are available at a significant discount to replacement costs.

Slate Office doesn't have any office assets in Alberta, and less than 3% of its NOI is related to the oil and gas industry. This is another factor that contributed to its outperformance in the past year.

## Conclusion

To avoid the uncertainty in Alberta, income investors can consider Slate Office for a yield of 8.8% in their diversified portfolio. In Q2, Slate Office reported a payout ratio of 84%, which was reduced from 105% in Q2 2015. Because of its accretive acquisitions and lower payout ratio, Slate Office's distribution is safer than it was a year ago.

## CATEGORY

1. Dividend Stocks
2. Investing

## TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:RPR.UN (Ravelin Properties REIT)

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