Dream Office Real Estate Investment Trst: Great Real Estate at a Fantastic Price

Description

The last five years have been quite painful for **Dream Office Real Estate Investment Trst** (TSX:D.UN) shareholders.

Things really started to go badly at the end of 2014 when oil really started to melt down. A large portion of Dream's assets were located in Alberta–a market that was really feeling crude's decline. As the local economy worsened in places like Calgary, Dream saw its earnings power start to deteriorate.

After years of struggle, the company did what no REIT wants to do: earlier this year, it announced it would be slashing its dividend from $0.186 per share each month to $0.125. Shockingly, shares actually rallied on the news, as investors liked the strategic plan announced with the dividend cut.

Dream's management identified $1.2 billion of non-core assets that would be sold with the proceeds going towards strengthening the balance sheet. And the new dividend would come with a payout ratio of approximately 60%, which is quite sustainable.

Many investors have long since gotten out of Dream, deciding they want nothing to do with a company that cut its dividend and has large exposure to economically weak areas. But these investors are ignoring a number of things the company has going for it.

Cheap assets

There are several kinds of value investors. Some focus on intrinsic value, realizing a company's moat is far more valuable than the market realizes. Others focus on companies with a temporarily depressed income stream. And many will simply identify mispriced assets, planning to buy when the assets are cheap and sell when they return to fair value.

It's obvious Dream's assets are quite mispriced.

At the end of the second quarter, Dream's management estimated the company had a net asset value of $23.64 per unit. That compares to the net asset value at the end of 2015, which was closer to $32 per unit. Shares currently trade at $16.87–a discount of 29% of net asset value.

You can probably guess why the company wrote down so much value. Assets in Alberta just aren't worth as much as before. At the end of 2015, Alberta's assets were valued on the balance sheet at $1.66 billion. After two massive write-downs, those assets are now carried at a market value of $931 million.

Here's the interesting part of that write-down: a year ago, occupancy in Alberta was at 88%. These days, it's closer to 84%. Additionally, rents have fallen about 20%, and it's likely most tenants will request concessions to re-sign leases. Things are bad, but I think many investors are forgetting Alberta is still more than 80% leased.

And when things start to improve in the province, look for Dream to quickly write-up the value of real estate in Calgary.

Cheap earnings

Dream's earnings will likely trend downwards over the next year or so, maybe even longer. Alberta will weigh on the bottom line, especially as the company sells assets in better markets.

Still, shares are trading at such a high earnings yield that this uncertainty is already priced in–and then some.

Through the first six months of 2016, Dream earned $1.33 per share in funds from operations. That puts it on pace to earn $2.66 per share for the year. Even if we assume $2 per share in funds from operations going forward, shares still trade at less than nine times earnings. You won't find many stocks cheaper than that.

It's also good news for Dream's new dividend–a payout of 8.9%. Even if funds from operations deteriorate to $2 per share, the company will still have a comfortable payout ratio of 75%. The current payout ratio is closer to 60%.

The bottom line

Dream Office REIT is cheap on a number of metrics, including net asset value and on a price-to-earnings basis. Yes, things look bleak, but any good value investor knows that's the time to be buying. It's for these reasons why Dream is one of my biggest positions.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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