Is Dream Global REIT’s +8% Yield Too Good to Be True?

Description

Some real estate investment trusts (REITs) are known to offer enticing yields. However, not all high yields are created the same.

Is **Dream Global REIT’s** (TSX:DRG.UN) 8.6% yield too good to be true?

Let’s first take a look at its business.

The business

Dream Global REIT owns and operates office and mixed-use properties primarily in Germany. At the end of the third quarter, it had 181 properties across more than 12.5 million square feet.

In the third quarter, the company earned 69% of its gross rental income (GRI) from major German office markets. Specifically, it generated 17% of its GRI from Hamburg, 14% from Dusseldorf, 10% from Cologne, 8% from Frankfurt, 8% from Munich, 7% from Berlin, and 5% from Stuttgart.

Dream Global REIT’s occupancy has improved for the last year and three quarters. At the end of the third quarter, it had a committed occupancy rate of 89.1%, which had a meaningful increase of 2.3% from the same period a year ago.

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Is its distribution safe?

Dream Global REIT’s improving occupancy is a good sign. But are the cash flows generated by its properties enough to cover its distribution?

That’s where the adjusted funds from operations (AFFO) payout ratio comes in. It is a stricter metric than the FFO payout ratio in determining the safety of the distribution. The REIT’s AFFO payout ratio is expected to be about 115% this year.

A big reason Dream Global REIT’s distribution is staying afloat is because of its distribution-reinvestment plan, which has had a participation rate of 13.2% this year.

Every time a unitholder reinvests their distributions, more units are issued, which dilutes current unitholders and makes future distributions less safe.

Thankfully, the operating environment in Germany has been improving. Also, the management team seems to be doing the right things in terms of operations.

Improving fundamentals

Since its initial public offering in 2011, Dream Global's average in-place rent per square feet has grown about 7.3% per year from EUR$7.13 to EUR$9.95. At the same time, its net asset value per unit has increased 11.3% per year from $6.76 to $11.27.

The company has also been reducing its concentration risk in Deutsche Post, which is its largest tenant. It used to contribute more than 85% of its GRI and now only contributes about 22%.

Conclusion

Dream Global REIT offers a high yield of 8.6%. For the time being, it's maintaining its distribution. However, its AFFO payout ratio is overextended, and its distribution-reinvestment plan continues to increase the number of its outstanding units. So, there's little to no room for error on management's execution.

Investors should be wary about Dream Global's 8.6% yield. To be on the safe side, be a spectator until its occupancy improves and its AFFO covers its distribution.

CATEGORY

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2. Investing

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