



Can This 12% REIT Dividend Be Trusted?

Description

In 2016, Motley Fool contributor Nelson Smith [wrote](#) that income investors should be wary of “safe” dividend stocks. Even if a company can continue to pay a high dividend, a decline in the stock price could erase the benefits of the income stream.

“There’s one important thing investors can do to protect themselves,” Nelson wrote, “and that’s insist on a reasonable valuation.”

That brings us to **Slate Office REIT** (TSX:SOT.UN), a REIT stock that is currently yielding 12.4%. Many income investors would be skeptical of such a high yield, and rightfully so. If such a high return could be counted on, surely the market wouldn’t price it so cheaply.

Still, Slate Office has paid out a consistent \$0.06250 monthly dividend since 2013 with zero lapses. With a six-year history backing the dividend, can this 12.4% yield really be trusted?

There’s one major risk

Slate bills itself as a “pure-play North American office REIT.”

More than 85% of its properties are located in Canada; however, nearly half are in Ontario, a huge number of which are in Toronto. That’s concerning considering this market could be in the midst of a giant bubble.

Douglas Porter, the chief economist at **Bank of Montreal**, recently [revealed](#) his bearish stance on Toronto real estate. “Let’s drop the pretense,” he said. “The Toronto housing market, and the many cities surrounding it, are in a housing bubble.”

He has a good case considering Toronto home prices have seen their fastest increase since the late 1980s, a period Porter says that “pretty much everyone can agree was a true bubble.”

Does that risk even matter?

While the value of the company's Toronto portfolio could be overstated due to historically high prices, the stock's rock-bottom valuation seems to fully account for this risk.

For example, the company's Greater Toronto Area Joint Venture Portfolio alone has a book value of \$530 million. That's more than the entire market cap of the company, which is currently \$420 million. Its remaining U.S. and Canadian properties have a combined book value of around \$1.3 billion.

When stripping out debt and working capital, the net asset value of Slate Office REIT is around \$644 million, or \$8.55 per share. With a current price of \$6.04 per share, the stock trades at a 30% discount to its theoretical value.

Let's say the company took a 50% loss on its Toronto properties. What would the value of the stock be then?

The company would have assets worth about \$1.6 billion, while its debt and working capital needs would stay static at \$1.2 billion, leaving \$400 million leftover for shareholders. With a market cap of around \$420 million today, that means there's fairly little downside to shares, even assuming a rapid deterioration in Slate's key market.

Here's what to do

Barring a real estate collapse in Toronto, Slate can likely continue to service its monthly dividend, meaning the 12.4% payout would be safe. If the Toronto market turned south, however, expect this payout to be slashed.

Encouragingly, the actual value of the company likely wouldn't be much lower than it is today. In total, this isn't the safest high-yield dividend, but even if the income were cut, the current valuation may not sink much lower.

If you'd like to bump your income levels up a bit while not taking on excess downside risk, Slate Office REIT looks like a great supplement to your portfolio.

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rvanzo

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