

## Industry Top Trends 2021

### Real Estate

#### Recovery In The REIT Sector Could Be Long And Uneven



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#### What's changed?

**Third-quarter results show signs of recovery.** Rent collection improved sequentially as businesses reopened after lockdowns. There is limited potential for rent collection to improve until a vaccine contains the COVID-19 pandemic.

**U.S. elections are largely neutral for REITs.** We don't expect meaningful impact under the new administration on credit quality. Regulatory policies affecting tenant protection or leading to higher taxes could have some negative impact.

**COVID-19 vaccine news provides better visibility.** Our recast and sector base case include wide availability of a vaccine by mid-2021, removing uncertainty.

#### What are the key assumptions for 2021?

**Retail real estate remains under pressure.** The acceleration of e-commerce will continue to hurt retail and erode tenant credit quality. Rent renegotiations, tenant bankruptcies, and store closures would hamper growth.

**Office real estate risks increase as corporate tenants consider downsizing.** We expect a slow return to the office, rising vacancy, and lower rent growth. Leasing remains weak, especially in dense urban markets, with more work from home.

**Valuation for retail and office will decline amid slowing cash flow growth.** Pressure on retail asset valuation could be prolonged through 2021. The impact on office assets is less clear.

#### What are the key risks around the baseline?

**The recent spike of COVID-19 cases will slow the pace of economic recovery and job growth.** This could mean a slower than expected economic recovery globally, dampen job growth, and limit consumer spending recovery.

**Merger and acquisition (M&A) risks impair credit metrics.** Asset price corrections could improve opportunities for REITs. Public retail and office REITs in the U.S. and Europe generally trade at discounts to consensus net asset values (NAV).

**Secular changes from COVID-19 could reshape real estate demand.** Risks include more store closures, tenant bankruptcy, and the work-from-home shift.

# Ratings trends and outlook

## Global Real Estate

Chart 1

Ratings distribution

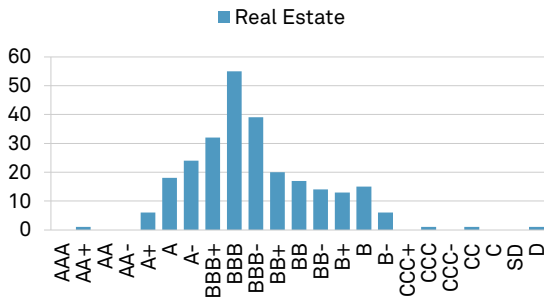


Chart 2

Ratings distribution by region

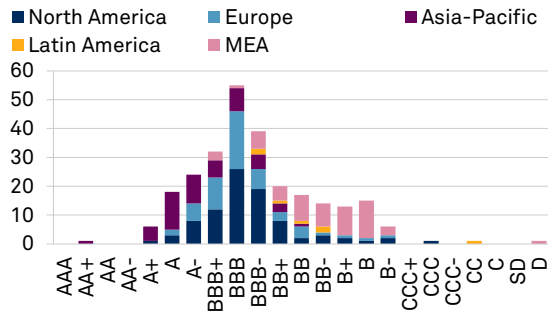


Chart 3

Ratings outlooks

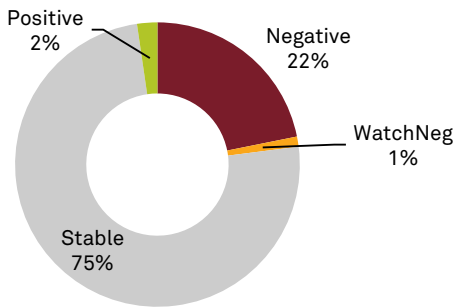


Chart 4

Ratings outlooks by region

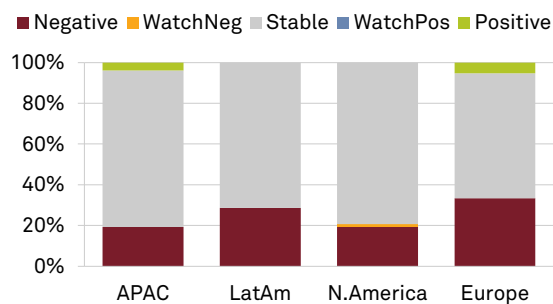


Chart 5

Ratings outlook net bias

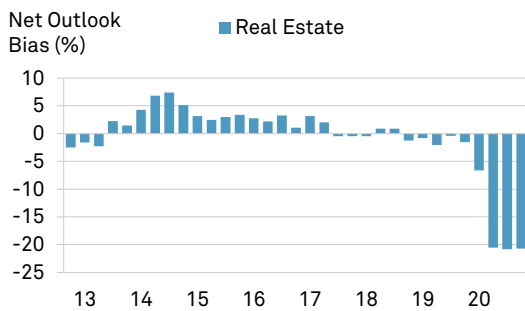
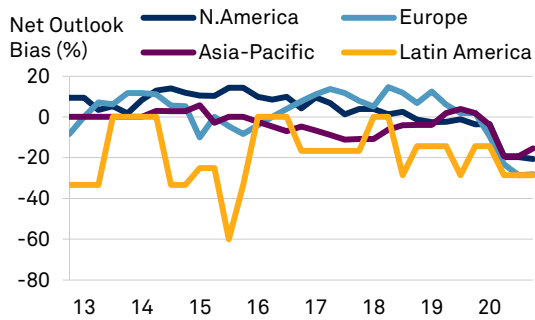


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter end. Data for Q4 2020 is end October, 2020.

# Shape of recovery

Table 1

## Sector Outlook Heat Map

	Sensitivities and Structural Factors			Shape of Recovery			
	COVID-19 Sensitivity	Impact If No Vaccine In 2021	Long-Term Impact On Business Risk Profile	Revenue Decline – 2021 versus 2019	EBITDA Decline – 2021 versus 2019	Revenue Recovery To 2019 Levels	Credit Metric Recovery To 2019 Levels
<b>Real Estate</b>							
Asia-Pacific REITs	Moderate	High	Moderate	0%-10%	0%-10%	2022	2022
Europe REITs	Moderate	High	Moderate	0%-10%	0%-10%	2022	2022
Latin America	Moderate	High	Moderate	0%-10%	0%-10%	2022	2022
North America REITs	Moderate	High	Moderate	0%-10%	0%-10%	2022	2022

Source: S&P Global Ratings.

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

This report does not constitute a ratings action.

# U.S. REITs

## Ratings trends and outlook

We maintain a negative ratings bias for the North American REIT sector as the impact of the COVID-19 pandemic and resulting recession affects REIT credit quality. We have taken 26 rating actions since early March, mostly outlook revisions, as well as downgrades within the retail, health care, office, and net-lease sectors. There were three fallen angels in the health care, leisure, and lodging sectors, and we downgraded two regional mall REITs multiple notches to the 'CCC' and 'CC' categories. We expect negative rating activity to continue over the next year as we monitor the potential recovery in real estate demand and REITs' progress in restoring credit metrics to pre-pandemic figures.

The pandemic could have a long-lasting impact on real estate utilization, particularly for retail, office, and health care assets. Some 30% of retail and office REITs have negative outlooks, compared to 20% for the overall portfolio. COVID-19 is accelerating the impact of e-commerce on retailers with ongoing tenant quality erosion, particularly for malls. For office, higher than average leverage and development risks provide limited cushion for underperformance. In addition, the longer-term impact of remote work could weaken demand fundamentals for gateway markets for both office and rental housing assets.

## Main assumptions about 2021 and beyond

### 1. U.S. real estate demand remains pressured as recovery is fragile.

We expect the impact from COVID-19 to persist in 2021, though net operating income (NOI) will stabilize for most property types. Retail, leisure, and senior housing assets remain challenged, while pressure could increase on the office and rental housing sectors. Industrial and data-center assets remain well positioned to outperform other property types given the benefits of e-commerce and remote working.

### 2. Urban and gateway markets will perform worse than suburban markets due to an urban exodus.

Densely populated markets will likely underperform suburban areas as extended work from home drives an urban exodus in search of larger living spaces while office tenants ponder downsizing footprints.

### 3. REITs will preserve liquidity and focus on their balance sheets.

REITs have preserved liquidity and mitigated the impact of lower earnings on key credit metrics through dividend cuts, and curtailed both capital expenditures (capex) and acquisitions. REITs, like other investment-grade sectors, have maintained good access to the debt markets, bolstering liquidity.

We expect demand for U.S. real estate to remain under pressure from COVID-19 in 2021. While news of highly effective vaccines is encouraging, this was already part of our base case. We still expect the first half of 2021 to remain challenging while the pace of improvement could accelerate in the second half. Third-quarter 2020 results show signs of recovery with sequential improvement in rent collection, but leasing activity remains weak. We expect a gradual economic recovery, as job growth and improved consumer spending support a real estate demand recovery. However, office and rental housing REITs could face ongoing pressure due to extended work-from-home arrangements and move-outs from densely populated urban markets. Moreover, we think retail REITs could face continued operating headwinds if bankruptcies accelerate. Overall, we expect REIT

credit metrics to recover to pre-pandemic performance by 2022, with gradual revenue recovery, though some sectors could recover later than others, particularly retail and office REITs.

We expect urban markets such as New York, San Francisco, and others to underperform Sun Belt markets. Occupancy for rental housing REITs with greater exposure to urban markets was several percentage points lower than that of peers with suburban exposure in third quarter. We expect this gap to remain until workers return to offices in these gateway markets, which remains slow. We expect office REITs to face weak leasing activity as tenants consider downsizing their office footprints, and we anticipate slightly lower occupancy and deteriorating rents. We expect suburban offices to face less pressure than dense urban markets with more resilient occupancy. Still, given the staggered lease maturity for office REITs, we expect gradual deterioration.

Despite operating headwinds in 2021, REITs maintain solid liquidity and good access to debt capital markets given most are rated investment-grade. Debt issuance remains robust for U.S. REITs (\$66 billion of senior unsecured debt as of October) and could surpass the record set last year. Equity issuance remains significantly below 2019 as many REITs trade well below consensus NAV estimates. REITs have also been active in the green bond market, with several issuances in 2020. Among those, Federal Realty issued its inaugural green bond.

## Credit metrics and financial policy

While we expect credit metrics to recover from a depressed 2020, they will likely remain toward the weaker end for the respective ratings given the slow expected recovery. That said, we think REITs will maintain relatively conservative financial policies as they navigate this downturn, with a focus on preserving liquidity. Many REITs have cut or suspended dividends, cut costs, and reduced capital spending or development activity to preserve cash. We believe most REITs have good liquidity, with adequate cash, revolver availability, or access to capital to withstand near-term pressure. Moreover, we believe REITs entered this recession in relatively better shape than the last, given lower leverage, a larger pool of unencumbered assets, and a well-laddered debt maturity profile that should help mitigate downside risks.

## Key risks or opportunities around the baseline

### 1. Slower than expected recovery is due to a second wave of COVID-19.

The recent spike of COVID-19 cases across the U.S. could mean a slower than expected economic recovery, dampen job growth, and limit consumer spending recovery, all of which could affect real estate demand.

### 2. COVID-19 accelerating secular changes could reshape demand for real estate.

The surge in e-commerce will likely pressure retail REITs as store closures and tenant bankruptcy risk remains high. A more permanent shift toward the adoption of work-from-home arrangements could significantly reduce office demand. These structural changes could further pressure asset values.

### 3. Industrial and data centers should benefit from e-commerce and work-from-home trends.

Strong demand relative to supply and secular tailwinds should support above average performance for industrial assets and data centers over the next few years.

Risk for a slower than expected recovery is heightened by the recent surge in coronavirus cases across the U.S. Greater social-distancing restrictions such as targeted lockdowns, reduced hours, or reduced capacity could hurt retail tenants and delay recovery prospects for retail REITs. A more prolonged return to the office could further pressure office and rental housing REITs as the exodus from urban markets intensifies.

The COVID-19 pandemic has accelerated secular changes directly affecting real estate demand. Retail REITs have managed the growth of e-commerce by diversifying their tenant bases toward more experiential offerings such as restaurants and movie theaters. Social-distancing measures and mandated store closings have disrupted this tenant base as well. We expect the performance of malls with a high portion of discretionary merchandising to underperform strip centers generally anchored by grocers and big-box stores that offer largely nondiscretionary merchandise. A more permanent adoption of remote working could lower the demand for office space over the next several years as tenants consider downsizing their office footprints to allow for greater work flexibility.

We expect industrial assets to remain resilient, with same-store NOI mildly positive in 2020 and growth accelerating in 2021. We anticipate favorable demand tailwinds to persist for industrial REITs as e-commerce and last-mile delivery continue to support demand. Data centers are also well positioned to outperform other property types given the accelerating demand for information technology infrastructure and connectivity from remote working trends globally. While there could be some rent pressure from large cloud providers, the strong demand relative to new supply should drive consistently positive same-property NOI growth over the next few years.

# European REITs

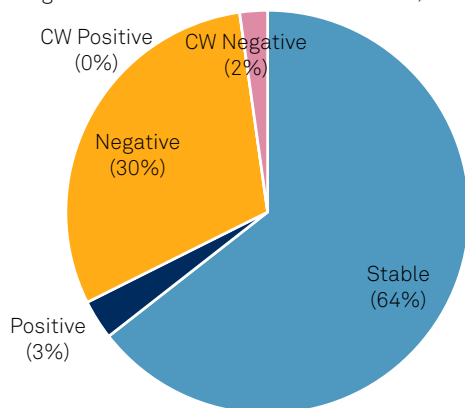
## Ratings trends and outlook

In 2021, REITs growth should remain dragged by the long-lasting consequences of the COVID-19 pandemic, specifically rental losses and higher vacancy. We expect revenues to reach 2019 performance only in 2022 on average, with the retail and hotel segments recovering later. Some 32% of our rating outlooks are negative, indicating possible downgrades over the next 12-24 months (see chart 7).

Chart 7

### Negative rating bias represents 32% of EMEA REITs

S&P Ratings Outlook Distribution for EMEA REITs, as of Nov. 20, 2020



Source: S&P Global Ratings.

## Main assumptions about 2021 and beyond

### 1. Retail rental income rebounds modestly in 2021, reflecting further probable rent losses and bankruptcies.

Rent renegotiations with retailers and tenant bankruptcies should continue to hamper retail REITs' growth in 2021. We assume revenue growth to rebound 0%-5% from 2019 before recovering gradually toward 2024.

### 2. Office revenues decline in the low-single-digit percentages, as occupancy and rental uplifts remain challenged by weaker tenant demand in 2021.

Weaker economies and work-from-home trends are likely to hamper demand for long-term office lease providers. Landlords should face difficulty addressing their next lease maturities as long as the market rental rate in the post-COVID-19 era remains broadly unknown.

### 3. Negative revaluations continue and reach 10%-20% below 2019 figures in some sectors, reflecting lower cash flow expectations and potential yield expansion.

Retail segment valuation pressures could be prolonged until year-end, reflecting continuous pressure on retailers. Office players should be less affected, although yields could expand more sharply for low-quality decentralized assets.

REIT revenue should rebound in 2021 but remain lower than in 2019, mostly due to higher vacancy, negative rental reversion, lower indexation, and potential further rent concessions to tenants. We therefore see a rent recovery in 2022 for most affected property segments, including office, and only after 2023 for retail landlords. Residential and logistic segments remain relatively immune to the COVID-19 pandemic and should be supported by strong fundamentals.

The retail sector is going through a secular change, with the rise in e-commerce and changing consumer habits exacerbated by the pandemic, and will likely take several years to recover. We assume retail REITs' lowest rent will rebound in 2021 only 0%-5%, after a cash revenue decline of 15%-30% in 2020, due to likely further bankruptcies and unrecoverable rent losses. We also believe leases under renegotiation could shift toward more variable proportion, leaving landlords with less revenue predictability.

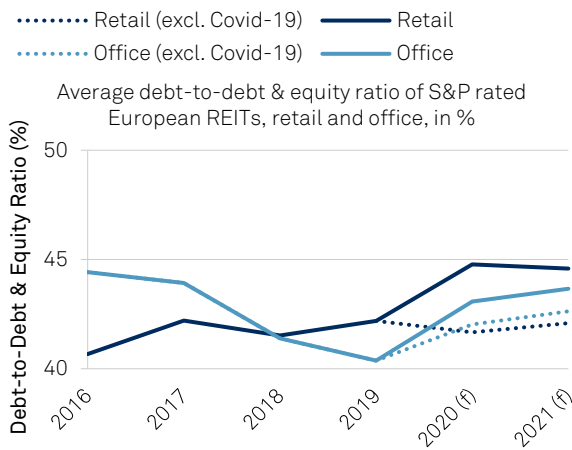
Office REIT rents, broadly flat in 2020, could gradually deteriorate in 2021 up to 5% as a result of weaker economic fundamentals and rising work-from-home penetration, which may push tenants to downsize their office spaces. Leasing market inertia, if prolonged, could lower rents and strengthen bargaining power for tenants. Next leasing maturities will therefore test office landlords, although tenants' exit options remain limited to 10%-15% of annualized rental income. We continue to view high quality, centrally located, offices assets, with low carbon emissions, as best positioned.

Valuations declines should remain moderate in 2020, in the 5%-10% range for retail and 0%-5% for office, under our initial estimates. However, we still believe pressures could linger toward 2021 and asset revaluations could decline 10%-20% over the next two years. This could be the result of lower cash flow expectations and yield expansion.

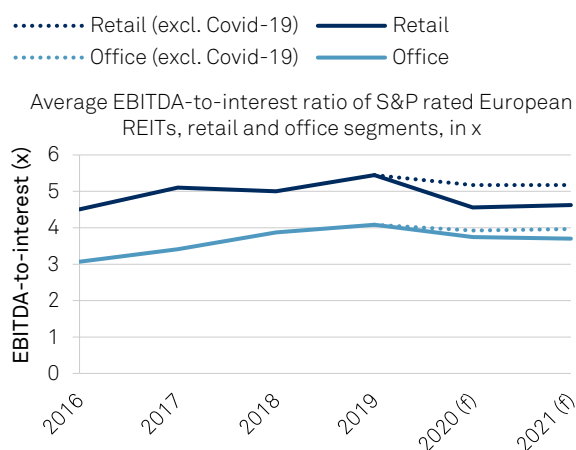
## Credit metrics and financial policy

COVID-19 pandemic is deteriorating both debt-to-debt and equity-and-debt-to-EBITDA ratios in 2020 (see chart 8). While debt to EBITDA should somewhat improve in 2021 with a gradual recovery in rent and deleveraging measures, we expect more deterioration and slower recovery of debt to debt and equity coming from further potential asset devaluations.

**Chart 8**  
Debt-to-debt & equity ratios should weaken further as values decline



**Chart 9**  
EBITDA interest coverage ratios remain satisfactory



f—Forecast. Sources: S&P Global Ratings, companies' reporting.

In 2021, there should be some benefits of dividend cuts, scrip dividend (payable in shares or cash), and downsized investments by most management teams. We believe the



execution of disposal plans could be compromised if the investment market remains subdued. Capital raises could also face strongly depressed equity valuations.

Most EBITDA interest coverage ratios should remain strong, supported by very low cost of debt and high interest hedging (see chart 9). During the pandemic, we've seen a strong volume of bond issuances for liability management purpose. Shorter maturities on new issuances and some recent yields tightening allowed most REITs to compensate for higher credit spreads and maintain low average cost of debt.

Liquidity buffers remain adequate and refinancing risk is remote. Even retail REITs whose revenues are the most challenged continue to enjoy good access to capital market and large undrawn bank lines that would enable them to cover debt maturities in 2021.

## Key risks or opportunities around the baseline

### 1. Harsher valuation declines than we expect.

A strong increase of capitalization rate by property appraisers would likely lead to revaluation losses that put REITs' financial profiles and covenants' compliance at risk.

### 2. M&A or aggressive take-overs.

Aggressive take-overs, in particular by private equity firms, or debt-funded acquisitions could be particularly detrimental to REITs' credit quality.

### 3. Further restrictions on nonessential stores.

Wider or stricter lockdowns coming into place could affect retailers more than we anticipate and lead us to change our ratings.

Since the start of the pandemic, the volume of direct investments has collapsed, especially in the retail and office segments. In the absence of private direct investments, third-party appraisers could turn to transacted volumes in the public equity markets as an alternative benchmark. If appraisers reflect more bearish sentiment in their assumptions, such as those in the equity market, mainly through higher capitalization rates, it would likely result in harsher revaluation losses. Those losses would weaken REITs' debt-to-debt-and-equity ratios and put loan-to-value covenants at risk.

European REITs exhibit a significant discount between share prices and NAV, which creates an M&A opportunity because it becomes more profitable to buy a REIT's shares than to buy its assets directly at their latest appraisal value. We think aggressive take-overs by private equity firms could be particularly detrimental to REITs' credit quality given the higher risk tolerance of the buyer and potential delisting of the target. Debt-financed opportunistic acquisitions by REITs could also lead to rating pressure, as they would likely hamper leverage ratios.

COVID-19 cases are picking up again in Europe. This has led several governments to restore restrictions such as closure of nonessential stores and restaurants, a large part of the majority of our rated retail REITs' tenants. While the recent finding of a vaccine brings hopes for an end to the pandemic in the near to medium term, a more pronounced economic impact on retailers from the second wave would likely make us revise negatively our base-case forecasts for REITs.

# Asia-Pacific REITs

## Ratings trends and outlook

We expect retail landlords to bear the brunt of the financial impact from social-distancing measures driving down footfall and rental concessions offered to tenants. These place pressure on ratings in the shorter term as economic activity and mobility in most markets within the region have improved significantly.

In the longer term, office demand will gradually be dampened by work-from-home arrangements becoming more permanent.

## Main assumptions about 2021 and beyond

### 1. Rent pressure could increase as government intervention lapses.

In Australia, government-mandated partial rent abatement offered by landlords to small and midsize tenants has reduced income mainly in retail operations. In Hong Kong, China, and Japan, rental concessions have been given out voluntarily. Rent collection will likely continue to be weak in Asia-Pacific (APAC) overall.

### 2. Rents to drop mildly.

We expect rents to drop moderately for both the retail and office sectors amid weaker occupancy. A downward cycle could appear if a pandemic resurgence significantly hampers economic activity, derailing recovery.

### 3. Lower asset values could hurt refinancing.

Weaker rents and cash flows will further cut asset values. Retail may continue to be subdued longer than pre-pandemic performance even as it recovered significantly. Offices will likely face a structural demand shift, but highly contingent on individual cities' supply and demand dynamics, economic outlook, and working culture.

## Credit metrics and financial policy

**Pacific:** Credit metrics will be subpar for retail landlords in fiscal 2021. However, we expect consumer activity will bounce back quickly, helped by robust policy support. This rebound is already underway in places where the pandemic is contained. Office landlords are not immediately affected, but increasing sublease space and soft business conditions will constrain earnings and temper the return to pre-COVID-19 credit metric expectations. Industrial landlords are forecast to maintain pre-pandemic credit metric expectations and will benefit long term from online tailwinds.

**Hong Kong/China:** In Hong Kong, we expect credit metrics to remain weaker than pre-COVID-19 mainly due to rental concessions given to tenants. In China, we expect them to recover in 2021 given consumption is slowly but steadily climbing out from pandemic troughs. Rental concessions were only 1-2 months and reflected in 2020's financials.

**Japan:** Credit metrics will be similar in 2021 to pre-COVID-19 figures. Moderate headwinds to occupancy and rental growth will continue in the office sector due to earnings pressure their tenants face and changes the pandemic to how work is done. However, we believe pressure on rental income will be largely mitigated by prudent financial management, such as reshuffling assets and curbing debt increases. For retail,

we continue to expect long-term, fixed-rate leasing contracts with high-credit-profile tenants to support credit metrics even amid the changing environment.

**Singapore:** We expect credit metrics of rated retail REITs to remain weaker than pre-COVID-19 figures through 2022, following debt-funded acquisitions in the second half of 2020. Retail REITs with more downtown mall exposure will likely face more continued pressure than their suburban malls counterparts, which rely less on tourist spending. COVID-19 has had a milder impact on commercial REITs, although earnings recovery in 2021 will be constrained due to new office supply and weak demand. Commercial REITs' credit metrics to trend toward pre-COVID-19 performance in late 2021.

## Key risks or opportunities around the baseline

### 1. More negative rating trend.

Our net negative rating bias (negative outlooks and CreditWatch placements) continued, with one issuer on the edge of falling into speculative-grade. Retail REITs are particularly vulnerable to further impact because many have increased leverage to fund rental losses from the first wave of COVID-19.

### 2. Fixed-rent structure in retail could change.

Landlords' bargaining power could wane amid weaker retail performance. For now, landlords are defending the fixed-rent structure of on average about 95%. For office demand, occupancy and termination trends, particularly in non-gateway cities, could indicate secular shifts.

### 3. Lower asset values could hurt refinancing.

Weaker rents and cash flows will further cut asset values. Retail may remain subdued longer compared to before the pandemic. Offices will likely be looking at a structural demand shift, but highly contingent on individual cities supply and demand dynamics, economic outlook as well as working culture.

Social-distancing measures, city lockdowns, and low consumer confidence will likely continue to erode earnings and credit quality of REITs and landlords over the next year. This will reduce rental growth trajectory and heighten vacancy.

**Australia:** The key risk to the country's economic recovery is greater corporate sector damage that weighs on hiring and job creation. We have maintained our GDP forecast of 4% contraction in 2020 but revised the rebound in 2021 to 4.2% from 5.3%. This reflects our expectation that tapering relief measures could slow but not stall the pace of recovery. Business failures and fragile confidence will drag on hiring, meaning that rising job losses are permanent. For the real estate sector, this economic backdrop is impairing retail landlords' rent collection and, more important, accelerating structural shifts to online retail. Many landlords have also recorded large asset devaluations in response to forecast declining rentals on lease renewals and subdued tenant demand. Office landlords also face longer-term structural strains from the move toward work from home. We expect tenants to look for greater flexibility in leases as they reconsider their space requirements, reducing occupancy and rental growth over the medium term. These structural threats, as well as cyclical challenges associated with a weaker economy, will remain a key rating focus for office landlords in 2021 and beyond. However, industries supporting online structural trends continue to thrive. Industrial landlords are riding the wave of demand for logistics services to support increasing online consumption.

**Hong Kong:** We expect negative rental reversions in 2021 from the prolonged weakness in retail sales. Most retail landlords may consider providing further rental concessions, albeit less than in 2020. This is because the drop in retail sales recently narrowed and mall footfall substantially recovered since August, when the pandemic became more or less under control. The hotel segment will continue to be very hard hit as travel recovery will hinge on a vaccine being widely distributed. We believe the tide has turned for Hong Kong office properties with negative rental reversion to start hitting in 2021 amid an uncertain economic outlook. However, this will gradually take time to filter through the large and stable portfolios.

**China:** We expect rent growth of less than 5% in 2020 and 2021. Consumption is slowly but steadily climbing from pandemic troughs. Landlords offered rental concessions for only 1-2 months, about the length of pandemic lockdowns. COVID-19 hit retail properties harder than offices, given social-distancing measures and lingering consumer hesitation amid low wage gains and rising unemployment.

**Japan:** Risks are slightly skewed to the downside for office and retail landlords because we believe negative impacts from changes in social needs could weigh more than we assume. This is incremental to the regular cyclical risks inherent to the industry. One supporting rating factor for issuers we rate is, however, their higher asset quality, which leads us to believe their better performance than the general market. Our base case scenario for vacancy rates in the Tokyo central business district office market is 6%-6.5% at year-end 2021, keeping an increasing trend from 1.5% in December 2019 and 4% in October 2020. Rents will be down low-single-digit percentages year over year. Consumer behavior will continue to change in the retail sector, which would work unfavorably for downtown properties. These scenarios are based on our GDP assumptions of 5.4% contraction for 2020 and 3.2% growth for 2021.

**Singapore:** We expect retail rental reversions will remain under pressure, despite a limited retail supply pipeline. Increased vacancies will be difficult to fill in 2021, as rental discounts and government relief through the toughest period of 2020 is unlikely to continue into 2021, while household spending will likely remain cautious. Furthermore, retail tenants with rising e-commerce sales will rethink their physical stores strategy. Nevertheless, the impact on suburban malls with high local resident traffic is likely to be lower. The hotel segment will continue to be weighed down in 2021, as recovery to pre-COVID-19 tourist arrivals remains some time away, despite the gradual increase in reciprocal travel arrangements. The pressure on office rental rates and occupancies in 2021 is expected to remain less than for the retail and hotel segments. Office tenants facing cost pressures and prolonged work-from-home arrangements will rethink office space needs and design.

# Latin America Real Estate

## Ratings trends and outlook

As of November, the outlook bias remains predominantly stable for real estate operators in Latin American countries, representing close to 70% of rated entities. However, since the beginning of 2020, we took an increasing number of negative rating actions; 30% of entities were downgraded with negative outlooks. This reflects our view of a deteriorated landscape for real estate activity in Latin America. The pandemic took a significant hit to real estate operations in the second quarter, affecting tenants across all asset classes, as economic activity and mobility faced a sudden halt. This triggered several relief measures from real estate operators to support their tenants. The impact has been uneven across asset classes, and we expect a slow recovery in 2021. Short-term downside risks remain significant as the evolution of rent collections will be key for landlords. In the longer term, occupancy of retail and office assets could face secular pressures, as e-commerce and remote working continue to accelerate.

## Main assumptions about 2021 and beyond

### 1. A gradual and lengthy economic recovery.

We do not foresee Latin American economies returning to pre-pandemic GDP growth until 2022, and some beyond. The region's structural challenges will not fade with the availability of a COVID-19 vaccine, meaning most economies will remain with subdued investment and consumption. As a consequence, we expect demand for real estate to slowly recover.

### 2. Rent collections to improve, but below 2019 rates.

Most real estate operators granted some type of rent relief in 2020, meaning lower revenues and rent collections. In 2021, we estimate operating and financial performance to normalize to some extent, improving issuers' liquidity position without major rent deferrals. However, we expect retail and office assets to continue underperforming, compared to industrial assets.

### 3. Lower investments and gradual deleveraging.

The pandemic has hit both supply and demand of the real estate sector. Although we expect conditions to improve in 2021, a majority of real estate companies revised their investment plans for the next couple of years. We expect capex to remain low, mostly relating to build-to-suit projects or asset expansions, if any. This should decrease financing needs and increase revenue, EBITDA, and cash collections, gradually improving leverage metrics for most issuers.

2020 was marked by a sharp economic contraction across most major Latin American economies, mostly from the pandemic and social-distancing measures taken by governments to contain it. We expect a 7.7% GDP contraction in Latin America's six major economies, with a lengthy recovery of 4.1% in 2021 and 3.1% in 2022. These assumptions consider that some countries, such as Mexico, will take longer to recover to pre-pandemic GDP growth rates. Moreover, given policies uncertainty, weak investment and low productivity, the region should emerge to its traditionally low GDP growth rates. As a consequence, we expect demand for real estate to only slowly recover.

Rent deferrals granted to tenants covered a majority of the second quarter, as social-distancing measures resulted in temporary closures of nonessential activities. This

affected EBITDA and rent cash flows for several real estate players, although retail portfolios were the most affected, while industrial portfolios were the most resilient. We expect rent relief in 2021, if any, would be limited to tenants severely affected by the pandemic, mostly related to entertainment sectors within shopping malls. As a result, we estimate income, EBITDA, and cash flow will partially recover from contractions of 0%-10% in 2020. Additionally, as e-commerce and remote work continues to deepen, we expect some pressure on occupancy rates of retail and office portfolios, which tend to average 88%-95% on rated issuers in Mexico and Peru, and closer to 75%-80% in Brazil.

Several real estate operators decreased projected investments in the next couple of years as a result of a weaker liquidity position in 2020 and uncertainty about the economy's and real estate market's progress in the next year. We expect a majority of new developments will be related to industrial assets, specifically on facilities designed for tenants on the logistics, distribution, health and e-commerce sectors. On the other hand, developments on retail and office portfolios have been delayed. Developers will proceed more cautiously on greenfield projects, reducing financing needs. Reduced investment plans, coupled with prudent financial policies, would result in a gradual deleveraging, although uneven across asset classes.

### **Credit metrics and financial policy**

The pandemic deteriorated top lines and EBITDA across the region, particularly during the second quarter. Our base-case scenario assumes issuers should return to pre-COVID-19 credit measures by 2022, although portfolios more focused on industrial assets with high-quality tenants would not significantly deviate in 2020. Moreover, we expect companies to maintain prudent financial policies without no full visibility on the upcoming path to a new normality or how a vaccine in 2021 could revert trends triggered by the pandemic. We do not foresee major M&A, although we expect such activity more with industrial assets than retail or office. Overall, liquidity positions deteriorated after the second quarter, and it remains the most relevant risk in 2021 due to the uncertainty of tenants operations. With weaker liquidity, debt-refinancing risks increase, albeit for specific issuers and not on a generalized basis.

## Key risks or opportunities around the baseline

### **1. Industrial assets remain resilient, with specific subsectors better positioned.**

Industrial portfolios suffered the least during the pandemic, as tenants were the least affected by lockdowns and tended to be international and high-quality tenants. We expect they will remain resilient through 2021, and those concentrated in logistics, distribution, e-commerce, and health sectors will likely continue important growth.

### **2. Subdued consumption affects retail portfolios and developments.**

Consumption slumped across the region in 2020, mostly relating to social-distancing measures. For 2021, we estimate consumption will remain below that of 2019, affected by a permanent loss in disposable income and high unemployment rates. Retail assets focused on nondiscretionary products should be relatively stable, while the recovery for discretionary retail will likely last beyond 2021. Rental income and cash collections for real estate players exposed to discretionary retail will continue under pressure.

### **3. Uncertainty remains with office real estate.**

During the second and third quarters, occupancy of office real estate across Latin America remained relatively stable, without major announcements on migration to coworking or remote working, but there is high uncertainty for the longer term.

An opportunity for real estate players relates to the robust demand for industrial assets with facilities specialized for logistics and distribution, along with e-commerce and health manufacturers. The COVID-19 pandemic accelerated already growing demand for these facilities. Mexican inventory remains the largest among the region, due to its unique geographic proximity to the U.S. market and structural competitive advantages that, with the United States-Mexico-Canada Agreement in place, should continue to provide incentives for local and international industrial players. On the other hand, we expect Brazilian industrial assets, a younger sector than Mexico's, will continue high growth, mostly concentrated for logistics, distribution, and e-commerce within the Sao Paulo metropolitan area.

Same-store-sales hit bottom during the second quarter, as many tenants from nonessential activities temporarily closed their stores. Despite shopping mall traffic recovering near 60% of 2019, we expect tenants focused on the entertainment and leisure sectors to continue underperforming and requesting some type of rent relief. Although variable rent slumped from a contraction in same-store sales, we expect fixed rent, which is the majority of rental income, should remain relatively stable in 2021. Moreover, we expect adoption of e-commerce will continue to increase in 2021, which may require brick-and-mortar retailers to reevaluate their strategies, resulting in gradual and lengthy pressure on demand for shopping mall space.

During the second and third quarters, occupancy of office spaces remained relatively stable, nonetheless many corporations continue to reevaluate their structures after being forced to implement work-from-home initiatives amid the pandemic and lockdowns. As with e-commerce adoption, we do not expect a faster adoption of flexible working policies (coworking, work from home, etc.) in Latin America than in developed economies. Office space per capita remains well below U.S. or European markets. Nonetheless, we expect that in 2021 and beyond, office spaces may need to be rethought, taking into account safe distance requirements, while flexible working policies will continue to expand.

# Other Regions

## Gulf Cooperation Council

**Sapna Jagtiani, Dubai**

The pandemic and a fall in hydrocarbon prices significantly lowered our economic growth forecasts for Gulf Cooperation Council (GCC) countries. We now expect a mid- to high-single-digit percentage real GDP contraction for most rated GCC sovereigns in 2020 and operating conditions to remain weak over the next few quarters. Most GCC nations host large foreign workers populations which we believe shrank modestly in recent months as incomes declined and employment weakened. Considering a notable real estate pre-pandemic oversupply, we expect rent decline to continue and linger well into 2021.

We expect retail and hotel real estate to be hardest hit, as revenue and EBITDA weaken. Even though lockdowns lasted for few months, rent relief measures (rent-free periods, discounts, rent deferrals, or other fees reductions) are likely to continue. The decline in tourists and social-distancing measures strained Dubai's retail sector, with footfall well below last year's and low consumer confidence affecting discretionary spending. Similarly, hotels are under pressure although recently eased travel restrictions and social-distancing constraints have spurred increase in occupancy and average daily rates. The recovery will likely take several quarters, possibly stretching into 2023. Moreover, Dubai's hosting of the 2020 World Expo, which was expected to boost real estate, was postponed to 2021. We expect the Expo is bound to lift the real estate market if there is decent visitor flow, though it remains oversupplied. We also think GCC office landlords will see rental pressure and lower occupancies as tenants continue to rationalize fixed costs and staff.

## Israel

**Hila Perelmuter, Tel Aviv**

More uncertainty and industry risk in commercial centers and offices during the COVID-19 pandemic will pressure the real estate market in Israel in 2021.

Commercial real estate asset performance is similar to that of the western world. Companies reported 30%-40% decrease in same-property NOI and a 0.5%-5% decrease in property valuations in the first half, given decreased rent flows. However, capitalization rates have not yet moved significantly. Accelerated structural changes in commercial centers that began before the pandemic, including online purchases and excess retail space, are expected to redefine strategy and business models of the companies. Property valuations do not fully reflect pandemic effects, with a high probability of further depreciation in 2021. It may be increasingly difficult for retailers, especially small ones, to survive the crisis as the recession lengthens and the online transition intensifies, which may decrease occupancy rates and pressure rents.

As for now, the performance of office properties shows only moderate impact. Rent collection and occupancy rates remained high. Tenants preferring to avoid moving offices due to high moving costs can explain this stability. In addition, tenants are still required to keep extensive spaces due to social-distancing limitations. Three factors can affect asset performance in the medium and long term: higher bargaining power of tenants; the development boost of new buildings in the center of the country, which may lead to an excess of office space in the coming years; and the work-from-home trend that may permanently reduce demand for office space, especially from the technology sector, the growth engine of the office segment in Israel in the past decade. These factors may lead over time to a 5%-15% decrease in same-property NOI and a negative revaluation of the assets by up to 10%.

Despite all the above there is to mention that the Israeli rated companies entered the crisis in a solid financial position and adequate liquidity, with a sufficient headroom



under our target ratios. In March and April, they prepared with sufficient cash cushions, took advantage of open capital markets by raising bonds, and drew down unused bank facilities.

## Related Research

- [German Residential Real Estate Is Unfazed By COVID-19](#), Nov. 30, 2020
- [Hong Kong's Tight Property Supply Becomes An Advantage](#), Nov. 24, 2020
- [COVID-19 Is Only Part Of The Threat Facing U.K. Real Estate Companies](#), Nov. 16, 2020
- [Urban Exodus Upends Rental Housing Landscape In Wake Of Pandemic](#), Nov. 10, 2020
- [China Commercial Property: Incumbent Advantages Today Suggest Credit Strength Tomorrow](#), Nov. 4, 2020
- [Japan Corporate Credit Spotlight: General Contractors; Real Estate; Electric Utilities And Gas; Railways; Airports](#), Oct. 22, 2020
- [Bearish Equity Market Sentiment Adds To European Real Estate Companies' Credit Risks](#), Oct. 9, 2020
- [Residential REITs: Why Renters Are Flocking To Suburban Markets](#), Oct. 7, 2020
- [European Office Real Estate Companies: After A Resilient First Half Upcoming Lease Maturities Should Test The Market](#), Sept. 18, 2020
- [European Retail Property Companies First Half Results Highlight Looming Risks](#), Sept. 3, 2020
- [REITrends: COVID-19 Pressured Second-Quarter Earnings And Credit Metrics For North American REITs](#), Sept. 2, 2020
- [Is The Worst Still To Come For Australian And New Zealand Companies?](#), Sept. 2, 2020
- [Retail REITs Will Contend With Retail Distress Until At Least 2021](#), July 21, 2020
- [Industry Top Trends Update: North America Real Estate](#), July 16, 2020
- [European Corporate Credit Mid-Year Outlook 2020](#), July 16, 2020
- [Rent Pressure and Development Delays Heighten Risks for U.S. Office REITs](#), July 2, 2020

# Industry forecasts

## Global Real Estate

Chart 10

### Debt to capital (adjusted)

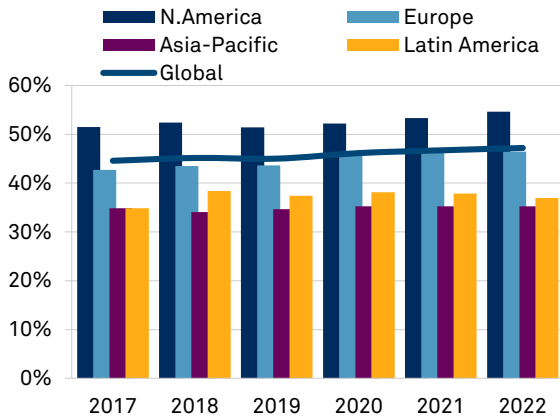


Chart 11

### EBITDA interest coverage (adjusted)

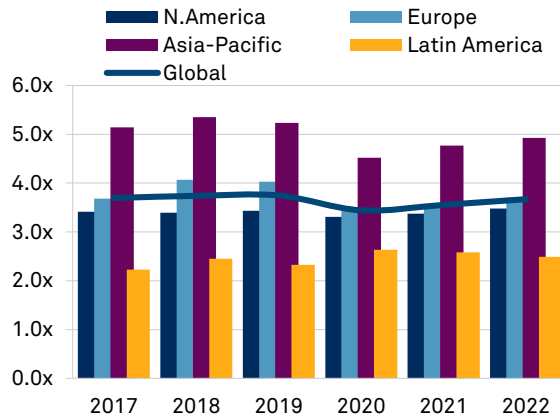


Chart 12

### Debt/EBITDA (median, adjusted)

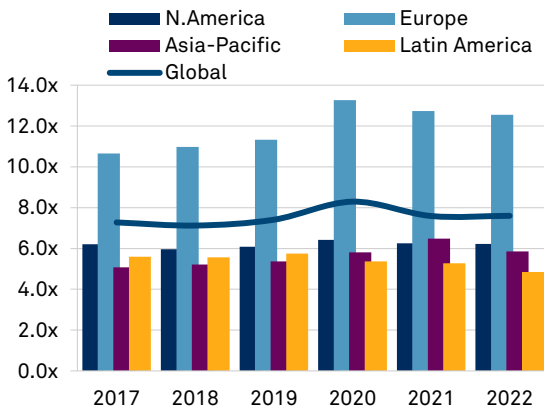
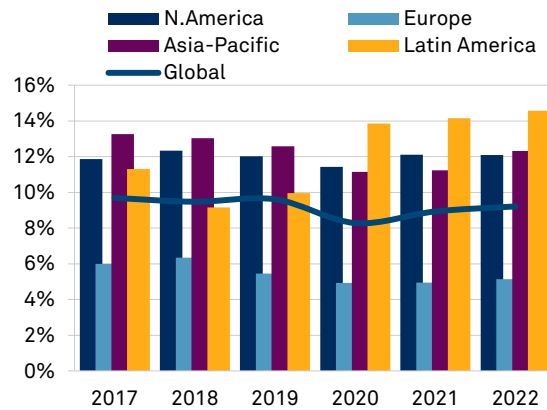


Chart 13

### FFO/debt (median, adjusted)



Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

# Cash, debt, and returns

## Global Real Estate

Chart 14

Rental revenue growth

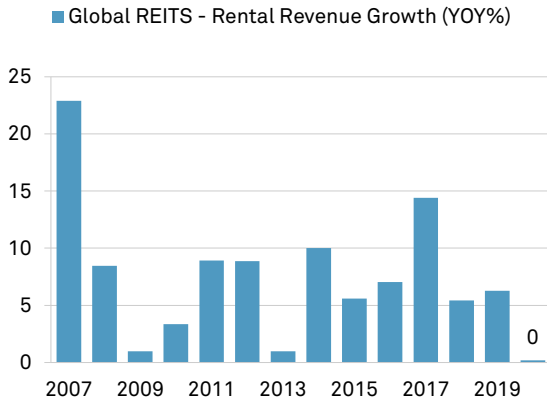


Chart 15

Return on capital employed

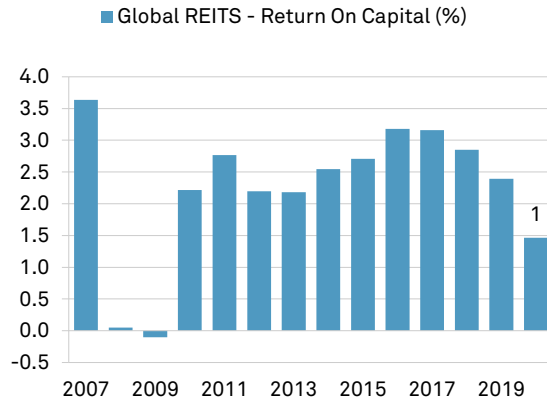


Chart 16

Fixed versus variable rate exposure

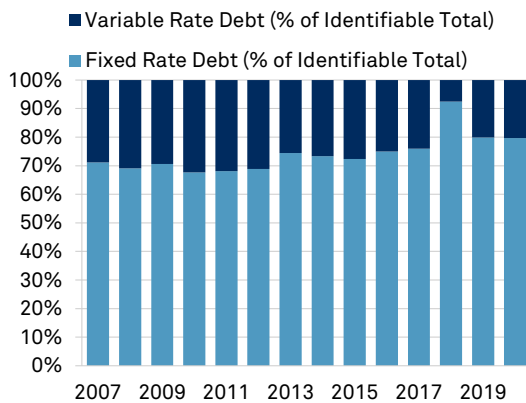


Chart 17

Long-term debt term structure

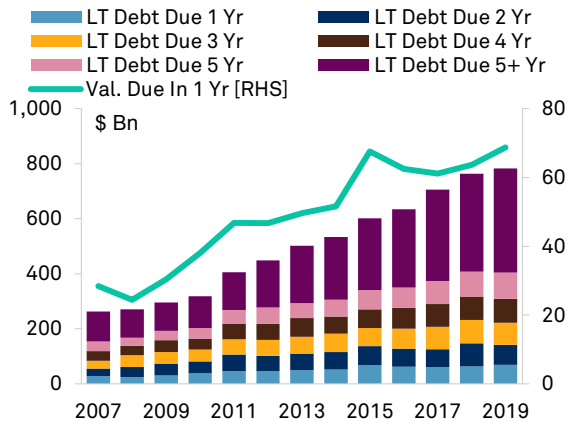


Chart 18

Cash and equivalents/total assets

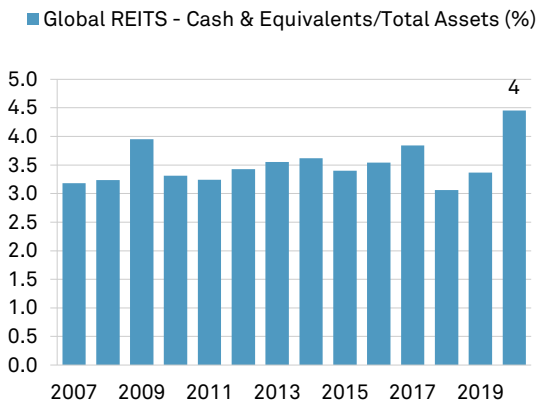
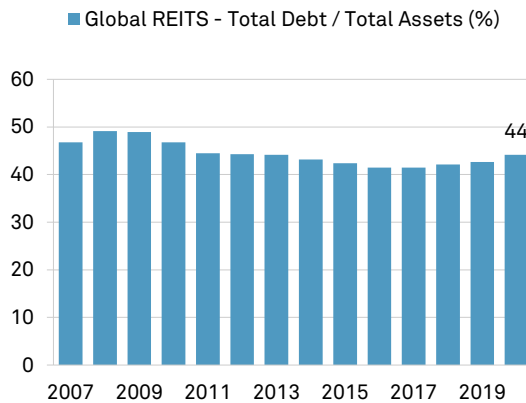


Chart 19

Total debt/total assets



Sources: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2020) figures are using last-12-months data.

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