S&P Global
Ratings

Industry Top Trends 2022

Homebuilders and developers

Credit Quality Mixed, Depending On The Region

This report does not constitute a ratings action

January 25, 2022

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What's changed?

Sales of communities in the U.S. High demand increased sales pace, which reduced communities for sale. These communities need to be replaced.

Tougher macroeconomic conditions in Latin America. Higher inflation, a still-weak labor market, and low GDP growth could pose risk for the housing sector.

Credit trends to diverge among Asia-Pacific developers. Chinese developers will still face liquidity strain, while Hong Kong developers can maintain stability.

What are the key assumptions for 2022?

Continued improvement in U.S. credit quality. Homebuilders are starting the year with healthy backlogs amid strong demand, which we expect will result in year-over-year improvement in both revenues and EBITDA.

European demand should remain healthy. Low interest rates and ongoing spending of household savings accumulated during the lockdowns will likely keep generating demand for new residential properties.

China to face a long downturn and Indonesia's recovery to slow. We expect a 10% decline in property sales in China this year, driven by restrictive policies. In Indonesia, the sales recovery may moderate after a strong 2021.

What are the key risks around the baseline?

Supply chain disruptions in the U.S. and Europe continue longer than expected. Shortages in certain building materials have increased cycle times and contributed to supply constraints and the production deficit.

Tighter lending conditions in the U.S. and Europe would likely hit demand. As home sales increasingly rely on mortgage sales, higher lending costs would likely hamper buyers' purchasing power and property developers' prices.

Property taxes rolling out to more pilot cities in China. More pilot cities implementing property taxes could affect homebuyers' sentiment amid the fragile market environment.

Ratings trends and outlook

Global homebuilders and developers

Chart 1

Ratings distribution

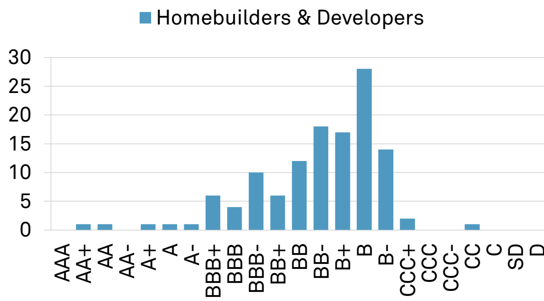


Chart 2

Ratings distribution by region

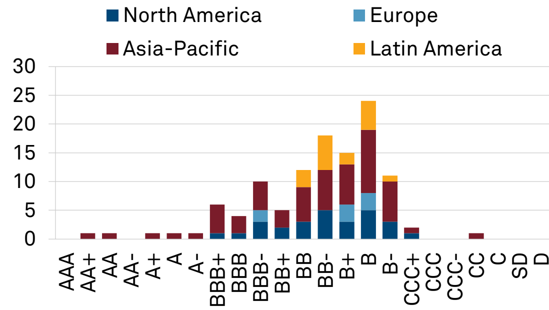


Chart 3

Ratings outlooks

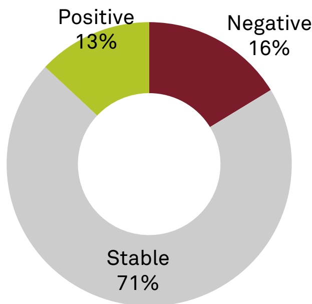


Chart 4

Ratings outlooks by region

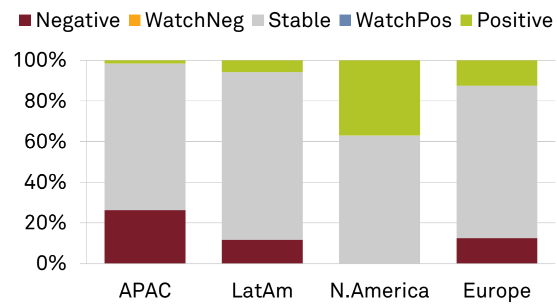


Chart 5

Ratings outlook net bias

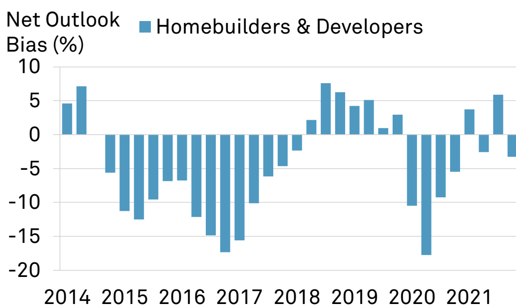
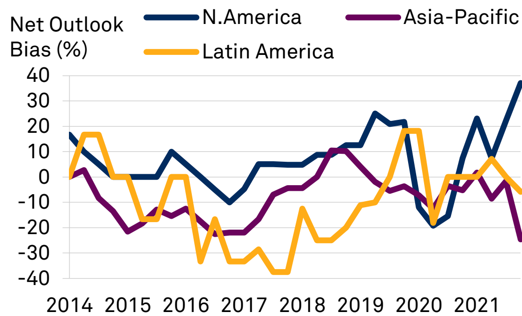


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter end.

U.S.

Ratings trends and outlook

Our outlook for the U.S. homebuilding sector has a decidedly positive bias. Of the homebuilders we rate, 37% have a positive outlook, indicating that we could see some upgrades over the next 12 months. The sector benefits from good long-term demand; stronger pricing amid tight supply; and record-low mortgage rates, good cost management, and judicious capital allocation. Many homebuilders have used this windfall to reduce debt and bolster land to protect balance sheets for an unpredictable--but inevitable--downturn. Even if the boom in homebuilder profits moderates in 2022 because of higher costs and less determined buying, we expect that most would sustain solid credit measures with robust profitability and lower debt levels.

As of Jan. 1, 2022, we rate 27 issuers in the U.S. homebuilding and real estate developer sector. Issuers' revenue ranges from $510 million to slightly over $27 billion. Currently, 19% of our ratings on U.S. homebuilders are investment grade ('BBB-' or higher) while 44% are speculative grade ('B' or lower). Of the rating outlooks, 17 are stable and 10 are positive. The outlook assesses the potential direction of a long-term credit rating, typically a one-in-three chance of a rating change over the intermediate term (typically six months to two years).

Main assumptions about 2022 and beyond

1. Home price growth is unsustainable at current levels

The industry's tight supply, in addition to strong demand, has caused an unprecedented increase in home prices over the past few months. Consequently, higher pricing so far is yielding stronger margins on lower volumes at smaller home sizes, which we expect to continue in 2022, albeit at a decelerating rate.

2. Recent gross margin expansion will revert to more normalized levels

As we expect home price gains to decelerate and cost inflation to persist, margins will likely begin to stagnate in 2022 despite demand remaining strong.

3. Operating performance will still be strong enough to improve credit quality

Homebuilders are starting the year with healthy backlogs amid strong demand, which we expect will result in year-over-year improvement in both revenues and EBITDA. Consequently, we expect homebuilders to continue to strengthen their credit quality and widen their credit buffer, which should protect them in a recessionary environment.

Supply chain constraints and higher costs have caused some leading homebuilders to lower their production guidance at the start of the year, confirming the industry's message that labor and land have been tight for the last few years. U.S. household formation appears solid, and the current peak in housing starts only recently neared the long-term average of 1.5 million-1.6 million. Slower foot traffic and closing process due to social distancing have accelerated the digitization of homebuying, enabling better sales conversion from more serious buyers and potentially lower costs. The industry's tight supply combined with strong demand has caused an unprecedented increase in home prices over the past few months. Consequently, higher pricing so far is yielding stronger margins on lower volumes at smaller home sizes, which we expect to continue in 2022, albeit at a decelerating rate. Last year, home prices in the U.S. rose faster than any other period. Between August 2020 and August 2021, U.S. home prices rose about 19.8%--the

largest uptick on record and well above the 12-month peak of 14.1% right before the 2008 housing crash.

We do not believe the recent home price gains are sustainable, and they have already begun to decelerate with the October results up 19.1%. Even so, home price appreciation has exceeded wage and income growth, which should worsen affordability. Homebuilders have some flexibility with pricing as higher-than-normal margins will allow them to implement incentives and discounts without profitability declining significantly. Based on our positive outlook for the sector, we expect to upgrade several homebuilders in 2022. Their financial discipline before and during the pandemic is yielding stronger ratios and a growing credit buffer, indicating that their credit quality is improving. We expect this credit buffer to widen in 2022 because we expect year-over-year improvement in both revenues and EBITDA as homebuilders begin the year with healthy backlogs and strong demand. On the other hand, if mortgage rates begin rising from record lows, this could slow the price growth that has sustained margins amid higher costs and an industrywide shift to lower price points.

Credit metrics and financial policy

Homebuilders will likely spend significantly more on land in the next few years to boost output. This is because they're replacing four- to five-year-old inventories (and some older) with land values that have risen more quickly since 2018. The shift to land options versus outright purchases is much different from the housing boom in late 2000s. Homebuilders now have less debt during a market upswing to cover a smaller pool of illiquid real estate assets.

We expect to see higher spending on land in the short term--through the first half of 2022--as homebuilders look to increase their community counts. The strong demand in 2021 increased the sales pace, which had an unintentional consequence of reducing communities for sale much faster than most builders expected. With stronger profitability accompanying strong demand, homebuilders are generating enough cash to not require significantly more debt to increase community counts or lots.

Key risks or opportunities around the baseline

1. Supply chain disruptions are continuing longer than expected

Shortages in certain building materials have increased cycle times and contributed to supply constraints and the production deficit.

2. Higher mortgage rates could affect profitability

Rates may rise because of stronger economic growth or higher inflation, which could slow the price growth that has sustained margins amid higher costs and an industrywide shift to lower price points.

Faced with longer cycle times due to building material shortages, inflation, and rapid home price appreciation, homebuilders have pivoted to a strategy of "metering" sales. This allowed them to sell product when they had some visibility on costs and deliveries, resulting in order declines in the second half of 2021 and limiting the significant growth in their backlogs that they experienced last year. Although we can't predict when these material constraints will dissipate, we do expect orders to begin increasing in the first half of 2022 and backlogs to begin normalizing.

We believe higher mortgage rates will have a greater impact on homebuyers with lower budgets. As rates rise, the monthly mortgage payment increases and constrains affordability for those deciding whether to buy their first home or to continue renting. If these consumers exit the market, it could alleviate some of the supply-side constraints and slow home price growth, which we expect would impact homebuilders' profitability.

EMEA

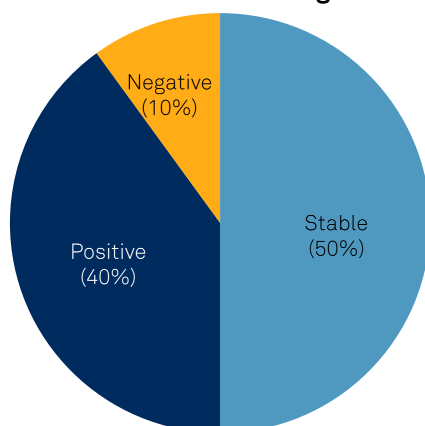
Ratings trends and outlook

Our outlook for European homebuilders and developers is stable to positive, with four positive rating outlooks out of 10 companies and only one negative outlook due to a transformative acquisition (see chart 7). The number of positive rating actions in 2021 largely outpaced negative ones.

Labor markets in the eurozone are quickly recovering, and we expect that the unemployment rate will drop by 0.4 basis points to 7.5% in 2022. Also, the release of pent-up demand should prolong the positive momentum for European homebuilders and developers at least for the next 12 months.

Chart 7

40% Of EMEA Developers Have A Positive Rating Outlook



Ratings outlook distribution for EMEA homebuilders and developers as of Jan. 7, 2022. Source: S&P Global Ratings.

Main assumptions about 2022 and beyond

1. Demand should remain healthy in 2022

Continued low interest rates and ongoing spending of household savings accumulated during the lockdowns will likely support demand for newly built residential properties in Europe in 2022. Russia, which experienced significant interest rate increases in 2021 that could hamper demand this year, is the exception.

2. Supply gap should narrow over time, limiting price growth

Although we expect supply to remain constrained, it may begin to improve in 2022 after numerous activity disruptions in 2020 and progressively catch up with demand. As a result, sales volume should remain steady, while price growth should slow in 2022-2023.

3. Cost inflation will test developers' margins

Cost inflation will continue to pressure developers' EBITDA margins and offset part of developers' revenue growth, by about 0.30 percentage points on average, at least until the second half of 2022, when we expect inflation to potentially cool down.

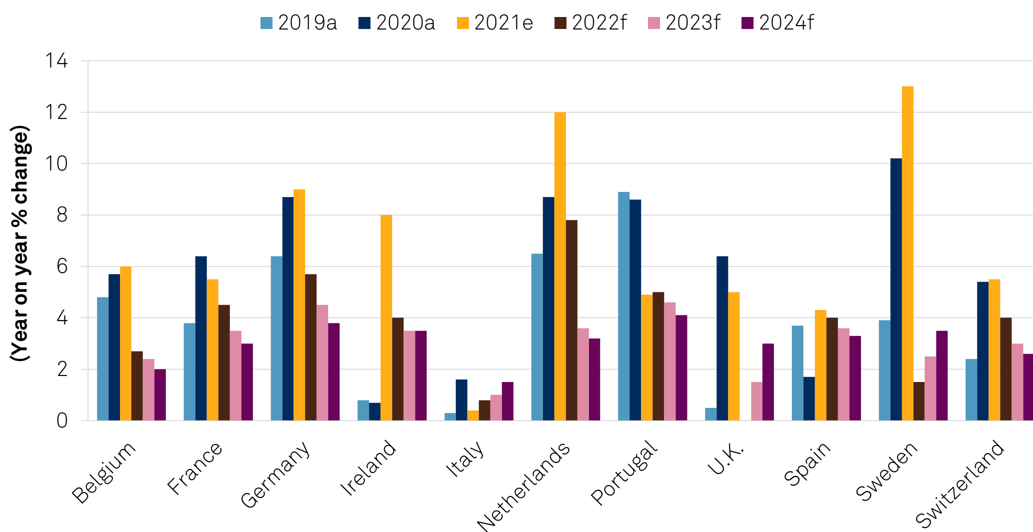
Demand for newly built residential assets in Europe didn't significantly tumble during the pandemic. On the contrary, government stimulus, low interest rates, and excess household savings have pushed orders and prices to new highs. But lower capacity and supply constraints have limited European developers' sales volumes. Several suffered from activity disruptions due to tightened security requirements, administrative delays, supply chain disruptions affecting materials, and labor force shortages.

Supply in Europe should remain constrained although potentially improve slightly, as the easing of pandemic restrictions and the still-accommodative monetary policies in Europe command higher sales volumes in 2022. Backlogs and order books are currently high. After two years of strong growth, price appreciation should start to slow in 2022-2023 (see chart 8), when the market absorbs accumulated household savings and the supply of units, which were constrained during the pandemic. We therefore think most European developers should achieve robust sales growth in 2022, which should surpass pre-COVID-19 levels by midyear if not sooner, before stabilizing in 2023.

The supply and demand situation is slightly different in Russia, where demand could be more subdued. Russia's key interest rate doubled between March 2021 and early 2022 (from 4.25% to 8.5%), which could adversely affect mortgage lending. Moreover, government stimulus in Russia has become more limited, which will likely deflate demand for newly built residential assets this year. At the same time, supply was strengthened in 2021, thanks to very positive price dynamics (around 20% through 2021) and a significant increase in construction starts.

Chart 8

S&P Global Ratings Housing Market Forecasts Show Housing Prices Inflation Is Here To Stay

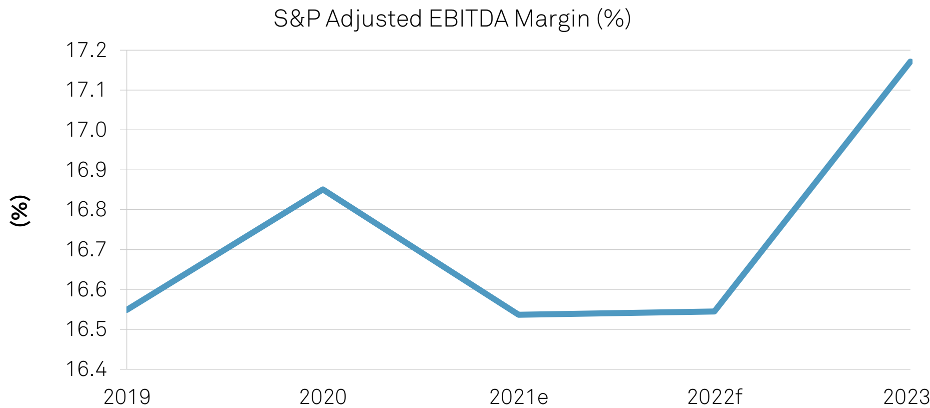


a—Actual. e—Estimate. f—Forecast. Year on year (%) annual growth in the fourth quarter. Sources: OECD, S&P Global Economics, European Housing Market Inflation Is Here To Stay, Nov. 2, 2021.

Building cost increases will likely persist and pressure European developers' margins this year, given the lack of building materials, higher energy prices, and labor shortages. We think the pressure could ease slightly in the second half of 2022, as we expect inflation to cool down. Only in 2023 do we expect developers' margins to inflate again, on the back of ongoing strong sales and easing cost pressure. We expect Consumer Price Index inflation to reach 2.0% and 1.5% in the eurozone in 2022 and 2023, respectively (see chart 9).

Chart 9

EBITDA Margins Should Remain Pressured By Cost Inflation In 2022



e—Estimate. f—Forecast. Average of S&P rated homebuilders and developers in EMEA excluding SIGNA Development Selection AG due to distortion. Source: S&P Global Ratings.

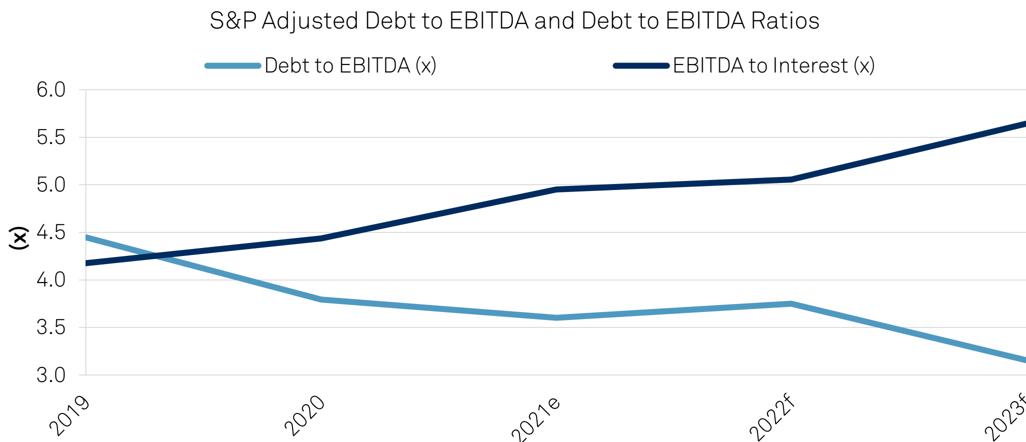
Credit metrics and financial policy

Leverage metrics should decrease across the board in the next 24 months and drop well below 2019 levels, except in Russia where the mandatory use of project finance loans constrains deleveraging efforts. This is due to solid cash flow generation, working capital inflow, and debt repayments. **Interest coverage should also remain strong** in 2022, as most developers decreased their cost of debt and improved their EBITDA-to-interest ratio by 0.5x on average during 2021 (see chart 10).

Spillovers from China's property market isn't likely to affect European developers because European issuers have no direct exposure to Chinese real estate and mostly depend on local trends and regulations. That could change only if conditions worsen in the debt capital markets in China and distress spreads to other developers or industries, pushing investors to reduce their risk tolerance. However, the property developers we rate in Europe have a large liquidity cushion that can cover upcoming debt maturities if their access to the debt market was suddenly restricted. This is because of recent refinancing, strong cash flow generation, and a healthy cash position.

Chart 10

Debt Leverage And Interest Coverage Should Improve Toward 2023



e—Estimate. f—Forecast. Average of S&P rated homebuilders and developers in EMEA excluding SIGNA Development Selection AG due to distortion. Source: S&P Global Ratings.

Key risks or opportunities around the baseline

1. Stronger or longer cost inflation could affect margins further

Stronger or longer cost inflation could affect European developers' margins if they are unable to pass through costs to their end customers.

2. Tighter lending conditions would likely hit demand

As home sales increasingly rely on mortgage sales in Europe, higher lending costs would likely hamper buyers' purchasing power and property developers' prices.

3. Growing environmental requirements favor demand for newly built residential properties

Regulation around buildings' energy efficiency is becoming stricter in several European countries, providing property developers with a competitive advantage against the secondhand market.

Stronger cost inflation could affect European developers' margins (10%-20%) if they are unable to pass through costs to their end customers.

The share of mortgage financing in property sales is high in Europe and has increased in recent years. Therefore, **tighter lending conditions** would likely affect developers' sales or their price flexibility, especially in countries where servicing household debt represents a high burden (the Netherlands, Sweden, and the U.K.).

In Europe, **environmental regulation** around housing is becoming stricter. We think this could provide property developers with a competitive advantage over the secondhand market, because their newly built assets are generally compliant with the latest environment standards, unlike older assets.

Other Regions

Gulf Cooperation Council

Sapna Jagtiani, Dubai

A gradual macro recovery, increasing oil prices, low interest rates, low real estate prices, and high vaccination rates were key reasons for buoyant real estate prices in the Gulf Cooperation Council (GCC) region in 2021. Government initiatives also offered a big boost to residential prices, which mainly aimed to attract foreign investors. The United Arab Emirates (UAE) recently introduced several new visa and residency schemes, as well as liberalized some social laws that contributed to the increase in residential prices. Qatar introduced new free zones for non-Qatari investors and granted residency permits to property owners, while in Saudi Arabia, the National Housing Co. intends to increase the percentage of Saudi families owning homes to 70% by 2030. Villas are on average benefitting more than apartments, though demand for bigger living spaces continues to rise due to COVID-19 restrictions. Also, demand associated with events such as the World Expo in Dubai and the FIFA World Cup in Qatar in 2022 is boosting rental rates.

UAE, especially Dubai, continues to benefit from increased foreign flows from the Indian subcontinent. We note, however, that oversupply continues to represent the biggest structural risk. New project launches--like those in 2021, with several years' lead time--will extend the oversupply and hamper the long-term outlook for price appreciation. We expect developers will see continued strong presales in the first half of 2022 and report improved revenue, cash collection, and profitability over the next few years as they build and deliver new units.

Israel

Gil Avrahami, Tel Aviv

Despite the significant increase in house prices of around 10%--the fastest pace since 2013--prices in Israel continue to rise. We expect an increase of 7% in 2022--on the back of recent tender land acquisitions, which closed at record prices--and the 5% increase in the construction input index. This is along with our expectations for further inflation pressure. Prices are also influenced by the 10% decrease in the inventory of unsold new units with only a mild increase in housing starts, indicating supply shortages remain.

We expect the companies to present higher revenue volume with better profitability, following these recent developments. On the other hand, the significant increase in land prices, together with the availability of cheap financing, may lead to an increase in the leverage of companies that won tenders.

The key risk is lower accessibility to funding sources for both banks and the capital market.

Asia-Pacific

Ratings trends and outlook

While the fourth quarter of 2021 was dominated by negative rating actions due to concerns in China's property sector, we expect credit fundamentals for Asia-Pacific property developers to be more diverged in 2022. In Indonesia, we believe that upside is limited based on developers' fundamentals, despite some improvement. The sales recovery may moderate, along with the tapering policy impact. There are some signs that Chinese developers' funding and liquidity are stabilizing, but the improvement will likely remain selective, and a considerable number of Chinese developers will still face a liquidity strain in 2022.

Main assumptions about 2022 and beyond

1. China's property sales expected to decline 10% in 2022

The downtrend may continue into 2023, where we project another 5%-10% decline, driven more by volume contraction. Credit tightening and restrictive policies are the key drivers for the downturn and are dampening homebuyers' sentiment, which are further impacted by fallouts of recent default cases. In our view, the policy finetuning including mortgage easing helps prevent a drastic decline, but it's unlikely to propel sales back to 2020 levels. There will unlikely be broad-brush loosening as seen in previous cycles.

2. There will likely be more defaults for Chinese developers

Defaults will rise as the cycle decline persists. The market faces sluggish sales and narrower funding channels with more cautious lenders, and some developers will find it difficult to upstream cash from project companies. We have downgraded 10 Chinese developers to the 'CCC' level or below over the past six months, which means we believe there is a default scenario for them. Six out of the 10 have already defaulted.

3. Hong Kong residential prices are still supported by limited supply

We expect residential transaction volume to normalize and decline from the peak, as prices have hit all-time highs, but pent-up demand seems to be partly exhausted. However, the structural supply shortage in Hong Kong should limit price corrections, which started in recent months. Although overall volume may taper, rated Hong Kong developers' contracted sales should remain intact due to their strong execution and market position.

We believe that authorities in China will likely maintain all the major policies including the three red lines, which are measures on developers' leverage and liquidity. As we understand, financial institutions in the country are capped on how much lending they can assign to the property sector, although there's been some ad hoc easing in that regard to sooth the overtightening. As such, we do not think that the overall policy landscape is changing in a substantial way yet, but it's worthwhile to see if authorities will further finetune some policies, such as the restrictions on presale proceeds.

Indeed, regulatory authorities and banks have introduced restrictions on developers' upstreaming presale proceeds from project companies. These are meant to protect the project-level lending as well as to ensure the projects are completed. While these restrictions are not entirely new, they play an important role in some Chinese developers' downfall as developers can't use project-level cash to repay bond maturities. We also understand that banks have likely placed even more stringent restrictions on developers,

which are under liquidity stress. Therefore, relaxation on this front can still make a difference, in our view.

Other than our recent downgrades of Chinese developers, we have performed a sensitivity analysis to gauge the potential liquidity stress under various scenarios. The analysis shows that about one-third of the rated Chinese developers' liquidity could come under pressure under our most severe scenario stress test. This assumes contracted sales are 20% lower than our base-case projection, a 30% repayment of minority interests, and 30% early repayment of trust loans.

Credit metrics and financial policy

For Hong Kong developers, we expect their credit profiles to stay steadfast despite some moderate volume and price correction. That is due to Hong Kong developers' adequate rating buffers, their strong and conservative balance sheets, and generally prudent financial management.

In Indonesia, developers' credit metrics are recovering on the back of a strong sales recovery in 2021, but upside is still limited. Sales momentum will likely slow to single-digit growth in 2022 as the impact of supportive regulatory policies fade. In addition, Indonesian developers' free operating cash flow will likely remain thin in 2022 with higher capital expenditure, while the policy on favorable mortgage loan disbursement likely won't be extended.

Key risks or opportunities around the baseline

1. Chinese developers' new bond issuances to have greater breadth and depth

Offshore bond issuances, despite being relatively small, only benefit a select few players, and only the stronger players can tap the market. Our base-case expectation is that the market will remain selective, but that may change if there is more calibrated loosening from the authorities even in the form of policy finetuning.

2. Property taxes will be piloted in more cities in China

Having more pilot cities implement property taxes is still a risk amid the current fragile market environment. The actual impact depends on tax rates and exemptions, but it may still affect homebuyer sentiment given the current market status. The rollout to more cities had not materialized by the end of 2021 as some market participants expected, but it remains a possibility in 2022.

3. Indonesian developers face refinancing risk beyond 12-18 months

Indonesian developers have limited refinancing needs for bond maturities in 2022. Their cash balances also provide some buffer for negative discretionary cash flow over the next 12 months. That said, some of the players will face significantly more maturities beyond 12-18 months, which may reignite the risk gradually as the domestic funding environment is still challenging.

As the property market downturn continues in 2022, we expect Chinese developers to face challenges with capital market refinancing. Although the recent issuance reopening is a positive sign, it is still selective, which we anticipate to be the case through much of the year. That said, capital market refinancing is still highly correlated to policy, which in turn affects companies' liquidity profiles. So, it also depends on whether more loosening, especially for the restrictions of presale proceeds, can be realized.

Latin America

Ratings trends and outlook

Our outlook on Latin American (LatAm) homebuilders and developers remains predominantly stable. Nonetheless, we foresee tougher macroeconomic and business conditions this year. The region faces higher inflation and policy interest rates, a still-weak labor market, and our expectation that key economies will return to traditionally low GDP growth. Brazil will also have general elections that could add further uncertainty to the sector. Moreover, the surge of cases from the Omicron coronavirus variant and potential for more widespread mobility restriction could also increase downside risks to our forecast. Those risks could slow housing demand, reduce homebuilders' growth prospects, and pressure profit margins, resulting in weaker credit quality over the next 12 months.

As of Jan. 17, 2022, half of our 18 homebuilder ratings are in the 'BB' category, while the other half are in the 'B' category, with close to 80% having a stable outlook. The stable outlooks reflect the homebuilders' solid liquidity positions and leverage cushions. Given that the sector is local in nature, we expect mixed results in 2022, depending on the country.

In Brazil, we expect a negative shift in housing fundamentals relative to 2020. We now anticipate fewer launches and a slowdown in sales growth resulting from higher interest rates and lower disposable income, while profit margins could be squeezed by inflationary pressures. Depending on the magnitude of these effects, we could see more outlook or rating changes during 2022. In Mexico, we expect the sector's modest rebound to continue, with housing starts likely approaching 180,000 units by year-end 2022. Rated Mexican homebuilders should continue to leverage their business flexibility and financial position to increase their market share and sales, while profit margins could be somewhat affected by higher inflationary pressure. Overall, 2022 is likely to be a turbulent year for the industry in LatAm, where controlled working capital management, healthy liquidity, and prudent financial policies will be key for homebuilders to maintain their credit quality.

Main assumptions about 2022 and beyond

1. Brazilian homebuilders' sales and cash flows to slow

Despite the ever-increasing housing deficit in Brazil, we expect homebuilder sales to slow down due to tighter disposable income and consumer confidence, as well as higher interest rates. We also forecast lower margins due to inflationary pressures and consequently weaker cash flow generation. While most of the rated Brazilian homebuilders have solid capital structures, they could face negative rating actions if credit metrics deteriorate beyond our current expectation.

2. Modest recovery trajectory for the Mexican housing sector in 2022

We believe Mexico's housing industry will have a modest recovery in 2022, despite tougher macroeconomic conditions. We anticipate housing starts to approach around 180,000 units in 2022. This is supported by resilient demand for new homes and healthy access to mortgage loans, at relatively stable interest rates. We expect rated homebuilders to grow by high-single-digit to double-digit percentage rates, while maintaining their credit profiles.

We expect rated Brazilian homebuilders will continue adapting their strategic planning for the next few years. In 2021, Brazilian homebuilders were hit with higher inflation rates and a different macroeconomic scenario than forecast at the beginning of the year. Our updated forecast suggests that there will be fewer launches, at least for the next couple of quarters, until uncertainties related to interest rates, inflation, and the presidential election dissipate. Mortgage rates have increased in recent months, reaching around 8%, on average, compared with 6% in 2020. This follows a rebound in the Brazilian basic rate to 9.25% in December 2021 from 2.25% at the biggening of 2021. We assume mortgage rates will remain highly volatile during 2022 as we expect basic interest rates to reach 10.5% in 2022 and 9.75% in 2023, negatively impacting consumers' purchasing power. This is on top of weaker consumer confidence, driven by general economic weakness and uncertainties related to the presidential election.

Therefore, we expect that rated Brazilian homebuilders will decelerate their launches, as sales growth will likely slow down during the year. Although demand for low-income houses is buoyed by the significant housing deficit in the country, we expect homebuilders to deliver lower sales volume as well as lower margins during 2022. The government program Casa Verde Amarela (CVA) has a price cap for its ties, which limit the companies' ability to pass through cost increases. This already impaired gross margins during 2021. We believe this trend may continue as labor cost inflation should be high over the next 12 months. Several low-income homebuilders opted to launch units priced slightly above the CVA caps, but we expect this segment to be negatively impacted by higher mortgage rates. Mid-to-high-income homebuilders raised prices to offset inflation, but their sales pace declined significantly during 2021. During 2022, we expect these companies to decrease launches and test the market through smaller price increases to balance their revenue and gross margins. Overall, we expect weaker cash flow generation driven by lower sales pace in addition to higher costs, though gross debt levels should remain broadly stable during the year.

Mexico's housing starts have shrunk significantly over the past six years, from close to 300,000 units produced in 2015 to 164,014 units in 2021. Housing starts reached record low levels in 2020 (151,366 units) due to historically low federal housing subsidies and the pandemic disruption. This year, we believe the sector will have a modest recovery trajectory relative to 2021 as we anticipate housing production to approach 180,000 units. In our view, the limited federal housing subsidy budget, planned at 4.3 billion Mexican pesos (MXN) for 2022, will still act as a drag and will likely prevent national production to surpass 200,000 units per year, as seen before 2019 when the housing subsidy was well above MXN6.0 billion per year. However, Mexico has a significant housing shortage of about 9.4 million units, and it benefits from supportive demographics, including a young population and growing middle class, coupled with formal employment gradually approaching pre-pandemic levels, although largely explained by recent labor reforms. Moreover, we expect Mexico's real GDP to grow 2.8% in 2022, and access to mortgage loans to remain healthy, with fairly stable mortgage rates, despite a hike in the central bank reference rate. We also anticipate government-owned entities Infonavit and Fovissste will continue expanding their housing programs and customer base, which should continue to give incentive to potential homebuyers. We expect house prices to increase faster than inflation due to the tight supply against the robust demand and inflationary pressures on building costs. In our view, those factors bode well for the housing sector's recovery through 2022.

In that context, we expect rated Mexican homebuilders--Consorcio Ara, S.A.B. de C.V. (national scale: mxA+/Stable/--), Inmobiliaria Ruba, S.A. de C.V. (national scale: mxA+/Stable/--), and Vinte Viviendas Integrales, S.A.B. de C.V. (global scale: BB/Negative/--; national scale: mxA/negative/--)--to continue leveraging their competitive positions and business flexibility from strong inventories, landbank reserves, and geographic diversification to raise top-line growth and increase their market share. For 2022, our forecast suggests rated homebuilders will increase their revenue base by

high-single to double-digits rates. In our opinion, this will be driven by an ongoing rebound in units sold and housing price adjustment at or above the inflation level to protect profit margins from inflationary pressure on building and labor costs. Finally, we believe that some players will improve their credit metrics, mostly from nominal EBITDA growth, but also from paying down financial obligations, reducing their funding costs, and becoming more efficient from a profit and loss perspective.

Credit metrics and financial policy

We expect rated Brazilian homebuilders to struggle amid more competitive and weaker market conditions. Despite being used to operating under high inflation and interest rates, companies are updating their strategic planning to adjust for such unaccounted economic changes. Most of the covered issuers in Brazil have a good liquidity position with extended debt maturity profiles, and we do not forecast major disruptions in the short term. Companies have learned the importance of maintaining strong liquidity, such that access to capital should not be an issue because cash remains an important asset on their balance sheet. We believe that construction financing will regain importance as banks maintain their appetite for risk. On the other hand, rising policy rates will pressure companies' interest burden and coverage ratios as well as consumers' purchasing power. At the same time, we expect sales of new units to decelerate, which will slow revenue in upcoming years and ultimately weaken credit metrics. For those reasons, we believe that negative rating actions could follow if those risks increase and persist. Our updated forecast shows that credit metrics for the period ending 2023 vary substantially from company to company. We expect 40% of rated homebuilders to slightly improve their funds from operations (FFO) to debt and cash flow from operations (CFO) to debt; 30% will maintain them; and the remaining 30% could see deteriorating ratios. When we look at capital structure, 35% of the issuers should see a deterioration in debt to capital, mostly due to expansion plans, while the others will maintain a relatively stable structure for the next few years.

We foresee rated Mexican homebuilders maintaining their healthy balance sheets in 2022 thanks to prudent financial policies. Rated issuers in Mexico maintain low leverage levels, extended debt maturity profiles, solid cash positions, and access to committed revolving credit facilities. Moreover, over the years they have demonstrated their capacity to access credit facilities and the local debt capital markets, while Vinte, for instance, also has raised equity to fund its growth strategy. We expect rated issuers to continue adhering to their prudent financial policies and to maintain their low leverage and healthy liquidity position in 2022. In our view, cash flows from higher units sold in 2022 should offset higher working capital requirements associated with increasing inventories, to meet housing demand in the market.

Key risks or opportunities around the baseline

1. Mixed expectations for Brazilian homebuilders

Homebuilders in Brazil will face rising interest rates, persistently high inflation, and declining wages this year. After strong results since the second quarter of 2020, there have been early signs of a cycle turn--particularly decelerating sales. Additionally, the deteriorating macroeconomics and the political instability from upcoming elections will raise concerns about sector performance. We expect companies to hit the brakes and take a more conservative approach.

2. Mexico's tougher macroeconomic environment could undermine industry fundamentals

The state of the economy will continue to influence Mexico's housing industry fundamentals. High inflation and labor market shortages pose downside risks for the industry's ongoing recovery and could put pressure on profit margins. We think larger players are better positioned to face these risks and could leverage their business flexibility to keep growing while maintaining their credit profile.

Brazilian housing sector to be impacted by external factors in 2022. Brazilian homebuilders have grown stronger from good business conditions over the past two years, though those days seem to have ended. Although we do not envision any short-term liquidity pressure, leverage metrics will likely deteriorate as companies reduce and postpone launches until they are more confident to accelerate launches again. Nevertheless, because of the accounting method--Percentage of Completion--and the recent strong results still to be accrued, the negative impacts from weaker-than-expected results are yet to be seen on their financial statements. Depending on each entity's construction cycle, we might continue to see operating cash burn and tighter margins in upcoming quarters. An alternative to boost cash flow generation, and apparently a trending one, will be the sale of receivables and performing loans.

Downside risks in Mexico remain elevated in 2022 due to high inflation and labor market weakness. Softer-than-expected economic conditions could result in a weaker formal employment recovery, lower household disposable income, a deterioration in consumer confidence, and ultimately lower housing demand and homebuilder growth prospects. This could in turn depress issuers' revenues, cash flows, and ultimately their credit metrics. Moreover, ongoing inflationary pressure on building material costs, mainly steel and concrete, could hurt homebuilders' operating margins and cash flows, particularly those exposed to lower value-added products, although rated homebuilders have in recent years been able to partially pass on these cost increases to homebuyers. On the other hand, we expect rated homebuilders to leverage their business flexibility and financial resources to gain market share in the highly fragmented market in Mexico, while protecting their margins.

Moreover, the surge of cases from the Omicron coronavirus variant and potential for more widespread mobility restriction could also increase downside risk across LatAm markets.

Industry forecasts

Global Homebuilders and Developers

Chart 11

Revenue growth (local currency)

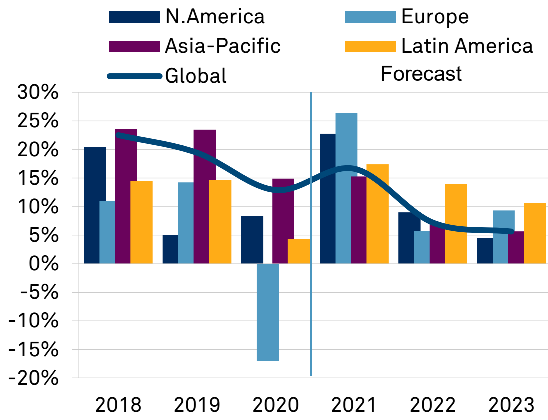


Chart 12

EBITDA margin (adjusted)

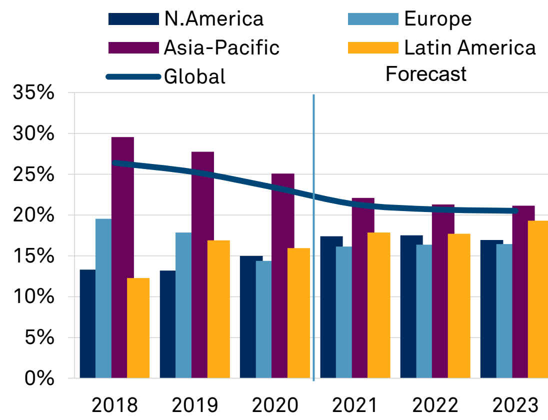


Chart 13

Debt / EBITDA (median, adjusted)

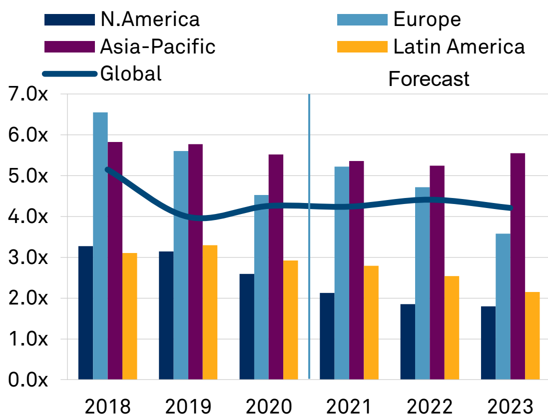
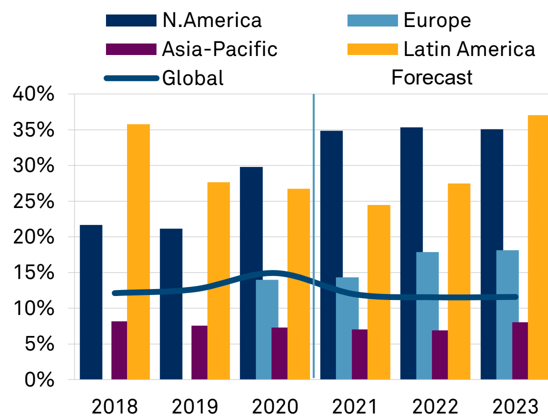


Chart 14

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 historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, debt, and returns

Global Homebuilders and Developers

Chart 15

Cash flow and primary uses

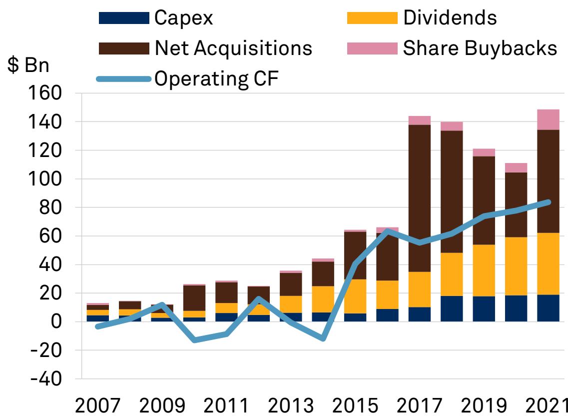


Chart 16

Return on capital employed

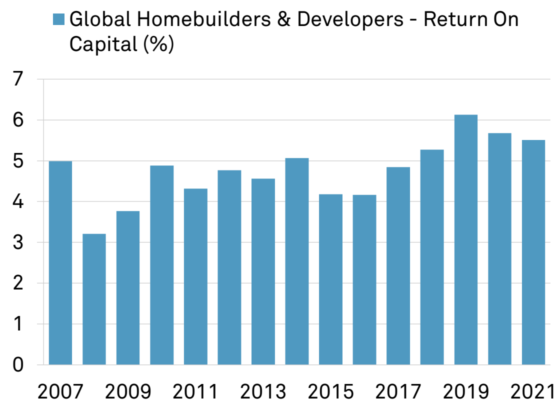


Chart 17

Fixed versus variable rate exposure

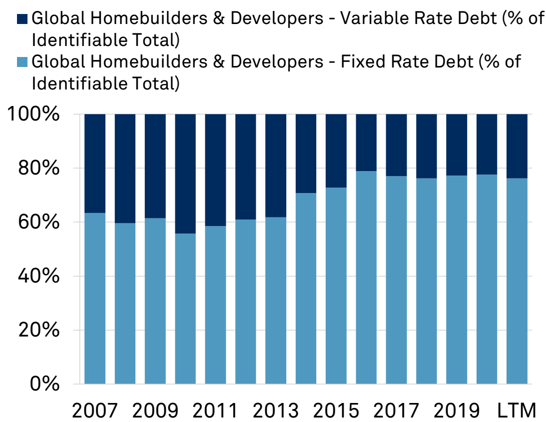


Chart 18

Long term debt term structure

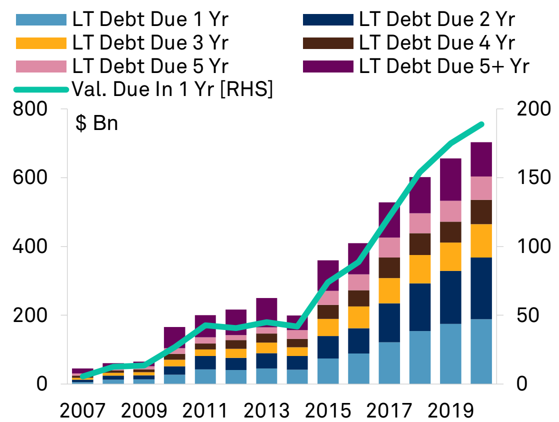


Chart 19

Cash and equivalents / Total assets

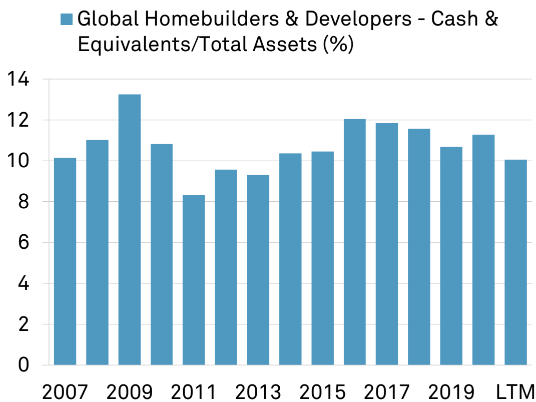
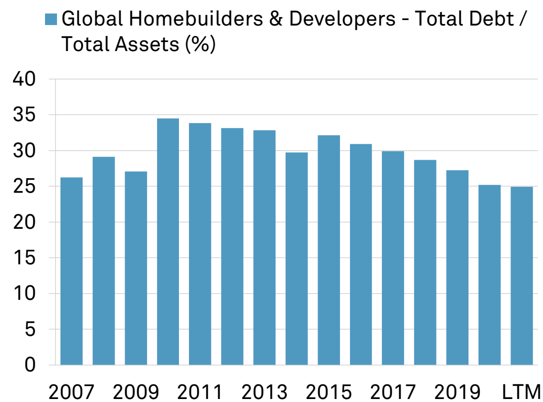


Chart 20

Total debt / Total assets



Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2021) figures are using last twelve months (LTM) data.

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