Industry Top Trends Update

Real Estate (REITs)

Inflation boosts revenue but rate rises a challenge

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What's changed?

Debt investor sentiment is significantly weaker, which could weigh on REITs' funding costs and refinancing plans. Bonds' spreads have materially widened in the sector since March 2022, raising risks of access to debt capital markets.

Soaring interest rates could slow investment and push cap rates up. Higher rates should affect investors' expectations for returns and put some gradual pressure on asset revaluations, unless rental income rise or risk premiums reduce.

Higher inflation should drive greater revenue growth. Rents rise with inflation because most leases are indexed to CPI, to the extent tenants can afford this increase, and most costs are passed through to them. Supply also becomes rarer as building costs increase.

What to look out for?

REITs might use shorter debt or alternative funding. Weaker capital markets could prompt REITs to make more use of alternative sources, such as bank mortgages or insurance loans, Schuldschein, and private placements; or issue shorter-maturity debt.

Debt service and LTV metrics will see headwinds, while debt to EBITDA might improve. If cap rates and funding costs rise, the former ratios should weaken or stabilize. The latter could improve as revenue increases and investment moderates, although a recession would likely dampen EBITDA growth.

REITs might invest less and rely more on asset disposals to fund their growth. As both debt and raw materials become more expensive, we believe REITs will likely reduce acquisitions and new developments capital expenditure, and possibly become net sellers.

What if there's a recession?

Revenue growth could erode because tenant demand would likely weaken. GDP contraction would likely hit tenants' capacity and willingness to expand their real estate footprints. Revenue growth might no longer be a catalyst in valuations.

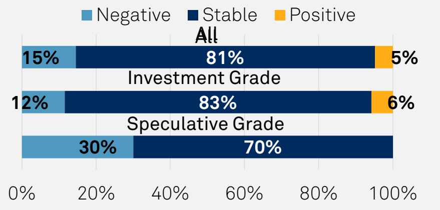
The office segment could be more vulnerable. While the segment has been relatively resilient to the pandemic, it is more cyclical and sensitive to economic downturns. A recession would likely hit corporates' expansion plans and demand for office space.

Retail and hotel recovery post-pandemic could derail. Weaker consumer sentiment and reduced purchasing power would erode retailers and hotel operators' revenue, ultimately affecting their landlords.

Latest Related Research

- [When Rates Rise: European REITs' Funding Costs And Cap Rates Climb, So Does Revenue](), June 16, 2022
- [[SLIDES] Russia-Ukraine Conflict: Implications For European Corporate And Infrastructure Sectors](), March 16, 2022

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	52	10	62
Downgrades	1	1	2
Upgrades	1	1	2

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias