S&P Global Ratings

Real Estate Investment Trusts

Higher-for-longer interest rates are hurting landlords

This report does not constitute a rating action.

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What do we expect over the next 12 months?

Asia-Pacific office landlords will continue to bear the brunt of structural and cyclical challenges. Valuation pressures remain for major Australian cities and Hong Kong.

Credit metric and covenant headroom diminishes as higher interest rates persist.

Logistics, hospitality, and retail (nondiscretionary) assets remain well supported.

What are the key risks around the baseline?

Higher-for-longer interest rates will crimp credit metric headroom. Landlords will be more exposed to elevated interest rates as their fixed-rate debt and interest-rate hedges roll off. This will weaken their interest coverage ratio and pressure covenant headroom.

Landlords' ability to monetize assets to deleverage will be constrained. Elevated interest rates will keep purchasers on the sideline, stymying landlords' efforts to deleverage. Sales of office assets at depressed prices will exert further downward pressure on office valuations. These could further erode gearing covenant headroom and funding avenues for our rated landlords.

What do they mean for the sector?

Financial buffers are thinning. While financial headroom is likely to diminish, we expect most rated Asia-Pacific REITs can still withstand the challenging operating and financial conditions. Cities with stronger return-to-office adoption or a continued increase in tourist arrivals will temper those strains.

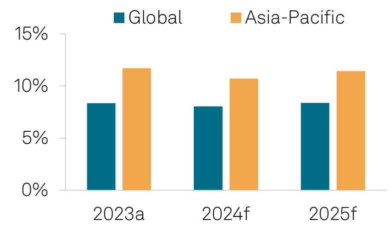
Office asset valuations remain under the spotlight. Further deterioration in valuations will increase gearing. As a result, some REITs' articulated targeted gearing ranges will be tested. Covenant headroom will decline but remain manageable for most.

Shorter debt maturity profiles to challenge liquidity. We may see a further reduction in debt maturity profiles as landlords opt for bank loans over bonds. A shorter-dated funding profile could weigh on the entities' liquidity and capital structure. That said, rated REITs' refinancing risk remains largely manageable.

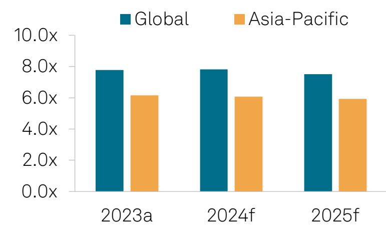
Multiple capital management levers to be pulled. Asset divestments, distribution payout reduction, deferral of non-essential capital expenditure, and equity raisings are some capital initiatives deployed by Asia-Pacific REITs under rating pressure. Capitalization rate stabilization should encourage capital inflows to the sector.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



Source: S&P Global Ratings.

All 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. a--Actual. f--Forecast.