S&P Global Ratings

Real Estate (REITs)

A little worse before it gets better

This report does not constitute a rating action.

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What's changed?

The negative rating bias remains high, but it is decreasing. Of European REITs, 29% currently carry a negative outlook, down from 33% in December 2023. We downgraded 18 companies since 2022, however, we have also taken a few positive rating actions recently.

Property valuations have declined by 9% since June 30, 2022. We assume another 4% decline in 2024, which will result in a 13% peak-to-trough average correction (with a maximum of 30%). After a two-year increase, debt-to-debt-plus-equity ratios should peak at about 4 percentage points (pps)-5 pps higher than the level in 2021.

Investor sentiment has improved, easing refinancing pressures. The bond market has reopened to most REITs (€10.8 billion issuances year to date, compared with €6.1 billion in 2023). Equity prices and credit spreads have improved, and recent hybrids' exchange offers were successful.

What to look out for?

Most interest coverage ratios (ICRs) should reach the trough by 2025. Steady revenue growth and debt reductions should allow 52% of S&P Global Ratings rated REITs to see their ICRs bottom out by 2025. For the remaining ICRs, the decline will last longer but will be more gradual.

Nonprime offices show more vulnerabilities. Low economic growth and changing office utilization patterns should weigh on occupancy and rent reversions and depress valuations more than other asset classes.

Rental growth should remain healthy and drive future valuations. Rent growth should exceed inflation for most segments until mid-2025 (longer for German residential) before normalizing. As rates stabilize, cash flow expectations will primarily drive next valuations.

What are the key risks around the baseline?

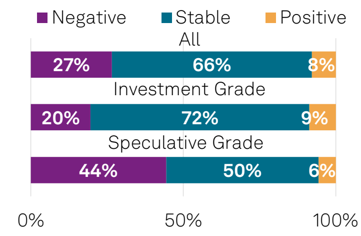
Distressed asset sales. Transaction activity remains subdued, especially in the office segment, and is concentrated on small transactions. Large institutional investors are constrained by allocation limits and refinancing struggles could force some asset sales at price discounts.

Political or geopolitical risks. Although not our base-case scenario, any strong effect on government bond yields or economic forecasts from political risks could potentially derail the recovery of REITs' valuations and hamper tenant demand.

Tighter regulation around properties' energy performance. This would require REITs to further increase renovations capital expenditure while the cost of capital remains high and access to funding has not fully recovered yet. Most REITs are focused on deleveraging.

Rating Trends

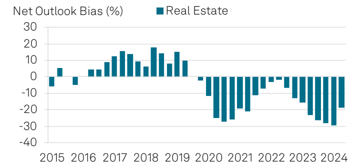
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	46	18	64
Downgrades	0	5	5
Upgrades	1	2	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	1.9	2.4
EBITDA growth (Y/Y%)	0.8	3.7
EBITDA margin (%)	75.6	61.8
Capex growth (Y/Y%)	-2.3	-1.0
Debt/EBITDA (x)	11.1	10.2
FFO/Debt (%)	6.5	4.1
FOCF/Debt (%)	0.3	-0.2

All data as of end-June 2024.
* Year-to-date. Current ratings only.

Related Research

Most European REITs' Valuations Should Bottom Out In 2024, July 10, 2024

Highlights From Our 2024 European Real Estate Conference, June 20, 2024

German Residential REITs Remain Supported By Funding Access And Solid Rent Fundamentals, May 31, 2024

AI In Real Estate: What To Watch As Adoption Accelerates, May 28, 2024

Swedish Real Estate: The End Of The Slump Could Soon Be In Sight, Feb. 29, 2024