S&P Global Ratings

Real Estate

Hopeful signs amid challenging conditions

This report does not constitute a rating action.

Ana Lai, CFA
New York
Ana.lai@
spglobal.com
+1 212 438 6895

What's changed?

Delay in rate cut heightened refinancing risk. Commercial real estate borrowers that postponed refinancing with hopes for a rate cut could get squeezed. As such, refinancing risk for debt maturities in the next two years remains high, particularly for struggling property types and properties.

Negative rating bias for office REITs increased. More than 80% of our rated office REITs have a negative outlook compared to 50% in early 2024. While leasing velocity has improved year-over-year, it remains below pre-pandemic levels. Meanwhile, office utilization remains subdued and tenant retention is relatively weak, suggesting further downside to occupancy levels.

Some rebound in debt issuance. Benchmark rates have stabilized and will eventually decrease. To that end, there has been a pickup in debt issuance in recent months as bond spreads tightened.

What to look out for?

Timing and pace of rate cuts. We expect the first rate cut in December and further cuts in 2025. Lower interest rates and narrowing bond spreads should support a recovery in credit metrics and improve access to capital.

Recovery in transaction activity. More certainty on future interest rates could bring greater transaction volume and price transparency (and losses). A more robust recovery may take more time, though the pace of decline in transaction activity is decelerating.

Stabilizing operating metrics. Demand for residential, retail, and industrial real estate remains resilient, and we continue to project cash flow stability in those sub-industries.

What are the key risks around the baseline?

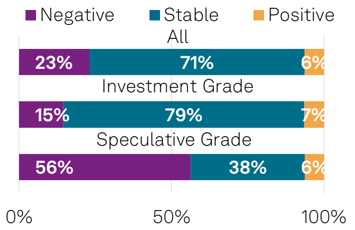
Tighter access to capital could narrow liquidity. Banks tightened lending standards as asset valuations declined and real estate fundamentals slowed, while access to equity remains constrained given the sector trades at a significant discount to net asset value.

Shorter weighted average maturity. Upcoming debt maturities are pressuring liquidity and financial flexibility for some office REITs and speculative grade credits, as the weighted average maturity of debt has narrowed over the prior year.

A further delay in rate cuts could keep valuation depressed. Asset valuations have dropped significantly and may not recover if the rate outlook worsens.

Rating Trends

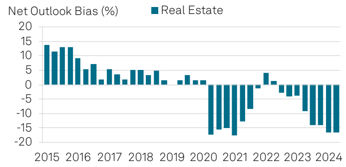
Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	62	16	78
Downgrades	2	7	9
Upgrades	2	1	3

Ratings Outlook Net Bias



Sector Forecasts (Median)

2024	IG	SG
Revenue growth (Y/Y%)	4.5	1.0
EBITDA growth (Y/Y%)	4.1	3.6
EBITDA margin (%)	64.6	59.6
Capex growth (Y/Y%)	4.6	0.0
Debt/EBITDA (x)	5.6	9.3
FFO/Debt (%)	13.6	6.0
FOCF/Debt (%)	11.3	3.5

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

Related Research

Signs of Stability Are Emerging Amid Challenging Conditions in Real Estate, July 2, 2024

CRE Debtholders Are Confronting Increasing Refinancing Risk and Charge Offs in 2024, June 3, 2024