Industry Top Trends Update

Real Estate

Fundamentals on track to recover

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

What's changed?

Recovery gaining traction. Robust economic growth and vaccination rollouts should drive demand. Rent collection has recovered, reaching the mid- to high-90% range across most property types, while occupancy remains stable. Leasing activity should pick up in the second half of 2021.

M&A activity increase. Transaction activity could pick up momentum given better outlook and recovery in equity prices. We've seen a sudden increase in M&A across the retail REIT sector, which could continue.

Moderating negative ratings bias. The upgrade-to-downgrade ratio was 4 to 5 as of June 30, 2021, versus 1 to 13 in 2020. Given stabilizing operating trends and improving cash flow, the negative ratings bias should ease from 18% as of June 30. Still, negative ratings bias is greater for some retail, office, and healthcare REITs.

How is recovery taking shape?

Cash flow improving. We expect net operating income growth for most property types in 2021 after declines in 2020, supported by higher rent collection, fewer deferrals, and a rebound in leasing activity. After negative trends in the first quarter, we expect positive growth starting in the second quarter as REITs mark the one-year anniversary of the impact of COVID-19.

Credit metrics should recover to pre-pandemic levels by 2022. We expect a gradual recovery over the next two years as operating trends stabilize after weakening in 2020. While REITs are gradually reinstating dividend payments, we expect they will remain below 2019 levels and be reset to more sustainable levels.

Good access to capital markets. Debt issuance remains strong in 2021. REITs maintained good access to debt markets given tightening credit spreads and low interest rates. Still, it is unlikely that debt issuance in 2021 will surpass last year's record of $23 billion, unless heightened M&A activity drives a significant increase.

What are the key risks around the baseline?

Debt-funded acquisitions. More aggressive financial policies could pressure ratings. Although we expect most rated REITs to focus on improving their credit metrics, debt-funded acquisitions or more aggressive share repurchases could pressure ratings over the next year.

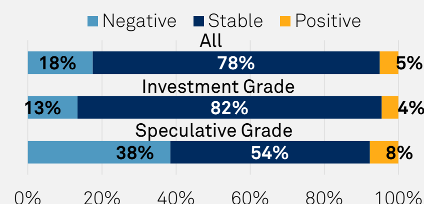
Slower-than-expected recovery. Lack of rebound in leasing activity could delay recovery. Leasing activity is starting to pick up after depressed levels in 2020. Still, re-leasing spreads are negative for malls and flat for strip centers, as tenant quality remains challenged. For office, a slow return to the workplace coupled with a high amount of sublease space could pressure rents and occupancy.

Secular change could delay recovery of some assets. E-commerce and remote working trends could hurt longer-term prospects for retail and office assets. Malls and outlets that are more exposed to discretionary retail are exposed to a weaker tenant base, while office focused in urban markets could see pressure from downsizing from hybrid work models over the next few years.

Latest Related Research

- REITrends: North America Recovery Picks Up Speed, June 10, 2021

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	67	13	80
Downgrades	3	2	5
Upgrades	2	2	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

Real Estate (REITs)	
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	Yes

2020 v. 2019		
Revenue Decline	EBITDA Decline	Incremental Borrowings
5% to 10%	10% to 15%	5% to 10%

2021 Estimates v. 2019	
Revenue Decline	EBITDA Decline
0% to 10%	0% to 10%