Real Estate

Office REITs lag the sector's recovery

January 14, 2025

This report does not constitute a rating action.

Contacts

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

Franck Delage
Paris
+33 1 4420 6778
franck.delage@spglobal.com

Santiago Cajal
Mexico City
+52 1 55 5081 4521
santiago.cajal@spglobal.com

Simon Wong
Singapore
+65 65396336
simon.wong@spglobal.com

Craig Parker
Melbourne
+61.3.9631.2073
craig.parker@spglobal.com

Sapna Jagtiani
Dubai
+971 43727122
sapna.jagitiani@pglobal.com

Gil Avrahami
Tel Aviv
+972 37539719
gil.avrahami@spglobal.com

What's changed?

Lower interest rates drive sector recovery, improving operating conditions and stabilizing asset valuations.

Improving access to capital alleviates some refinancing risk. Lower rates, tighter bond spreads, and recovery in equity prices will help companies refinance at lower costs.

Asset values will stabilize for most property types because valuations have reset at higher cap rates, though lower quality office properties are still under pressure.

What are the key assumptions for 2025?

Modest operating metrics improvement. We expect positive rental growth across most assets, but some office assets may see further deterioration.

Improving transaction activity. As valuations stabilize, landlords will have better ability to sell assets to improve financial flexibility.

Refinancing risk remains manageable for most due to recent rate cuts, improving access to capital, and other capital initiatives.

What are the key risks around the baseline?

Higher-than-expected interest rates could delay credit metrics improvement, which could keep financing costs high, pressuring credit metrics.

Landlords fail to monetize assets to deleverage on a timely basis. Inability to sell assets could limit financial flexibility.

More aggressive growth plans could jeopardize credit quality. Accelerating acquisitions, increases in dividends, or share repurchases could pressure ratings.

Ratings Trends: Real Estate

Chart 1
Ratings distribution

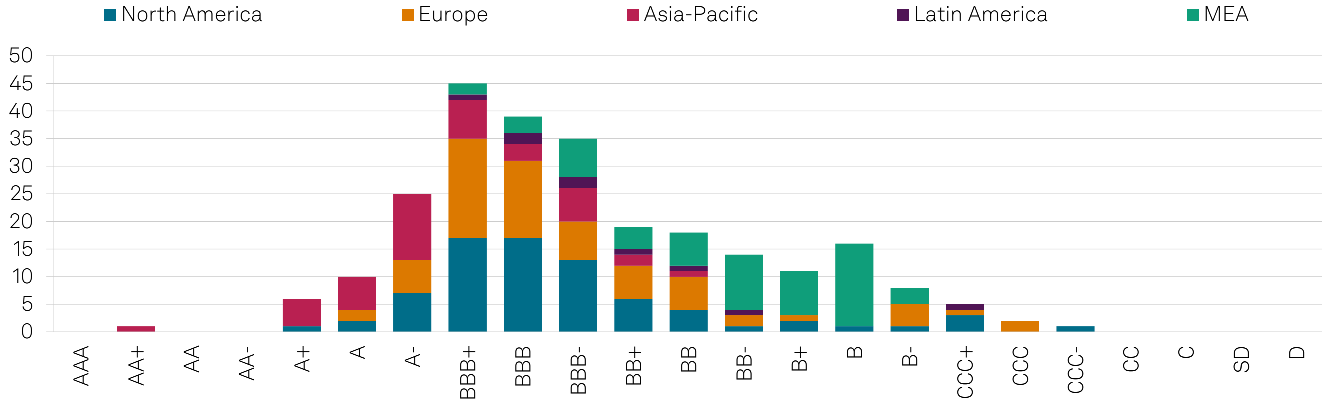


Chart 2
Ratings outlooks

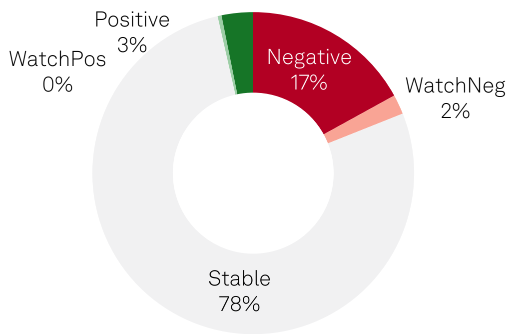


Chart 3
Ratings outlooks by region

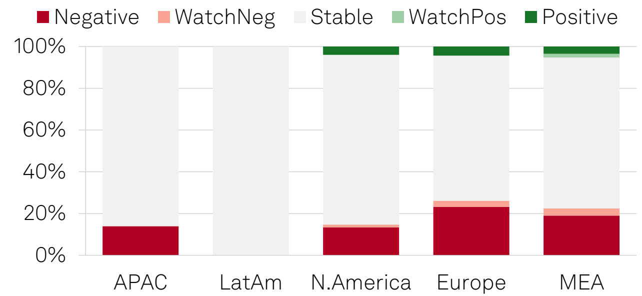


Chart 4
Ratings outlook net bias

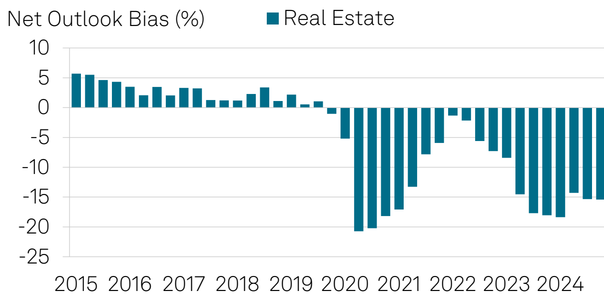
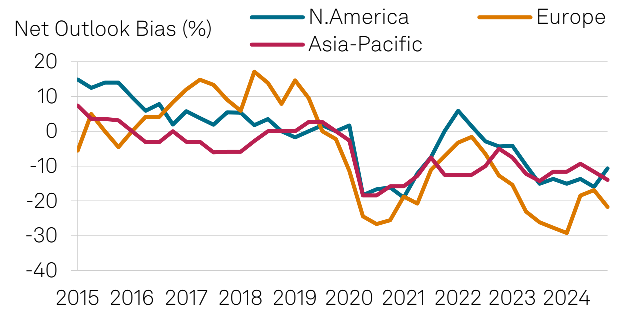


Chart 5
Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook: U.S. REITs

Ratings trends and outlook

We maintain a negative ratings bias on U.S. office REITs (about 36% of ratings have a negative outlook). Leverage for office REITs remains elevated compared to other property types, and material improvement among office REITs is unlikely in 2025 given below-average utilization and weak tenant retention relative to pre-pandemic levels. That said, office REITs' operating metrics are beginning to stabilize and access to capital has improved modestly following recent interest rate cuts.

In 2024, we downgraded 18 U.S. REITs and upgraded five. Most of the downgrades were because office REITs faced operating pressure from secular headwinds, and higher borrowing costs deteriorated their credit metrics. By contrast, we upgraded three retail REITs due to solid performance, increasing demand for high quality spaces, and improving credit metrics.

We expect downgrades will moderate in 2025.

Main assumptions about 2025 and beyond

1. Slower-than-expected rate cuts.

This may keep borrowing costs elevated through 2025, which could mute acquisition appetite.

2. Recovery in demand modestly improves operating metrics.

Demand for retail, housing, and health care assets remain resilient, with signs of stabilization in the office sector.

3. Access to capital has improved, and equity issuance is up year over year.

We expect volumes of transactions will increase in 2025 and improving equity prices will provide REITs better access to capital.

Elevated interest rates could pressure cash flow. We expect the Fed will cut interest rates more gradually than we previously anticipated. Despite a cumulative 100-basis-point rate cut in 2024, interest rates remain elevated and could pressure credit metrics as debt maturities are refinanced at higher rates. Therefore, refinancing risk for debt maturities over the next two years remains high, particularly for struggling property types. Upcoming debt maturities could pressure liquidity and financial flexibility, particularly for many speculative-grade issuers whose weighted-average maturity of debt continues to decline.

We expect net operating income (NOI) growth will remain modestly positive, given resilient demand. Leasing activity has been robust for retail REITs given limited new supply, resulting in healthy rent growth and high occupancy levels. While an increase in supply could constrain rent growth for multifamily REITs that have exposure to sunbelt markets, we expect rental housing will remain resilient given home prices remain high, and the 30-year mortgage rate is around 7%.

Most office REITs reported relatively stable operating results in recent periods due to some recovery in leasing and relatively stable occupancy. Higher-quality office assets show signs of stability, and tenants are focusing on landlords with more robust financial health and ability to invest in property improvements. By contrast, conditions remain more challenging for speculative-grade office REITs with lower quality assets.

We expect transactions to pick up over 2025. According to Coldwell Banker Richard Ellis (CBRE), commercial real estate investment volume stabilized in the third quarter, at $90 billion, down 2% year over year. Access to capital has improved for real estate companies because of narrowing bond spreads and higher equity prices. This led to higher debt and equity issuance in 2024, with public REITs issuing about $44 billion of debt through November 2024, compared to $37 billion a year ago. We expect transaction volumes will continue to increase in 2025.

Credit metrics and financial policy

We expect EBITDA interest coverage and fixed charge coverage will remain under pressure in 2025—particularly for issuers with significant upcoming debt maturities—as interest rates remain elevated. We expect debt to EBITDA will gradually improve across most property types due to organic low-single-digit percent NOI growth, although leverage will likely remain elevated for office REITs.

Given a tighter lending environment, some issuers have opted to refinance maturing unsecured bonds with shorter-term secured debt. Issuers facing sizable upcoming debt maturities could see tighter liquidity and financial flexibility, particularly for some office REITs and speculative-grade issuers. Because average debt maturity profiles shortened over 2024, we applied a negative capital structure modifier to several REITs with weighted maturity profiles of less than three years.

We expect the financing environment will improve as additional rate cuts boost REITs' access to capital markets. As financing costs decline, transaction activity could also gain momentum with more price discovery from an increased volume of transactions, which would support asset valuations. Historically, interest rate cuts have been positive for real estate given the sector's capital intensity. We expect asset values will stabilize after the reset in cap rates for most property types, although the office sector could remain under pressure.

We expect U.S. REITs will increase their acquisitions in 2025 as cap rates stabilize. We expect well-capitalized REITs with balance sheet capacity will pursue a more normal level of acquisitions following a period of muted activity.

Key risks or opportunities around the baseline

1. Rates remain elevated for longer due to inflationary pressure.

Higher-than-expected inflation could keep interest rates higher than expected. This could delay the recovery in credit metrics.

2. Recovery of office REITs more robust than anticipated.

Signs of stabilization in leasing trends are emerging for certain markets and continued momentum could lead to better-than-expected rental growth and occupancy trends.

3. More aggressive growth plan that results in higher leverage.

A more aggressive acquisition strategy, particularly for higher-rated REITs, could pressure credit metrics if funding is largely debt-financed.

S&P Global economists expect inflation will remain above the 2% target for longer than expected, with the 10-year Treasury rate staying around 4% over the next year. If inflation remains elevated for longer, the pace of interest rate cuts could also be delayed. This could stall the improvement in credit metrics and limit transaction activity.

The recovery of office demand could be stronger than expected due to better-than-expected job growth or if tenants decide to expand their footprints as employers implement stricter return-to-office (RTO) policies.

Following a period of low acquisition activity, we expect REITs will increase growth through higher acquisitions and development activity. While we expect rated REITs will remain disciplined in their growth strategies, larger-than-expected debt-funded acquisitions could pressure credit metrics.

Industry Outlook: European REITs

Ratings trends and outlook

Since 2022, 20 European real estate companies have been downgraded. In the beginning of 2024, 27% of rated European REITs had negative outlooks or were on CreditWatch with negative implications, which is an improvement from 33% a year before. Most asset classes saw significantly improving funding conditions and stabilizing valuations.

Rated European REITs bond issuances reached €19.3 billion in 2024, an increase from €17.0 billion and €5.3 billion in 2022 and 2023, respectively. We expect the sector will continue to improve in 2025.

Main assumptions about 2025 and beyond

1. Rental income growth will normalize, not stabilize.

We believe rental income will remain positive across most property segments. Low supply will support rents and occupancy.

2. Valuations will be stable, except for nonprime offices.

Government yields have decreased and somewhat stabilized, so valuations will increasingly be the result of rent growth expectations and capital expenditure (capex) requirements. However, nonprime offices, which face rising vacancy and obsolescence, could lose more value.

3. Investment market will revive gradually.

Transactions will likely resume in 2025 as funding conditions improve. Moreover, repricing is reducing the price gap between buyers and sellers.

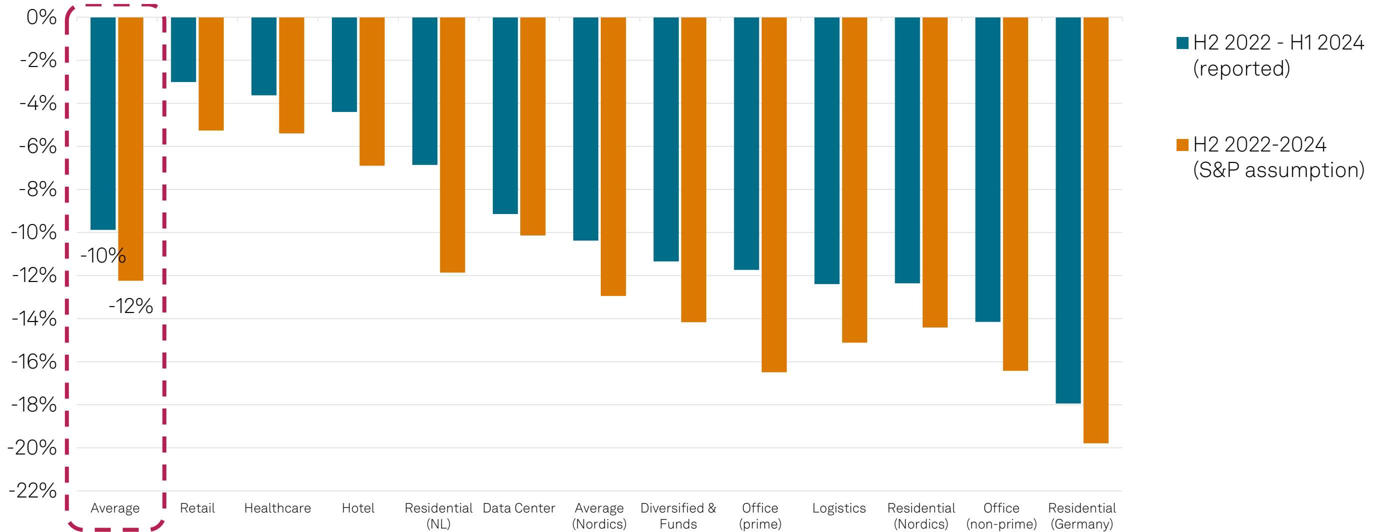
Rental income will grow in 2025 for most asset classes, albeit more moderately than 2024 due to lasting tailwinds from inflation. We forecast CPI inflation in the Eurozone will be 2.1% in 2025, down from 2.4% in 2024. We also expect rental growth will benefit from improving consumption levels and increasing GDP growth. We expect real GDP growth will reach 1.2% in the Eurozone in 2025, versus 0.8% and 0.5% in 2024 and 2023, respectively. Residential rents will continue to be supported by a strong housing shortage, particularly in Germany and Sweden, and elevated indexation. Retail landlords will likely benefit from rising real disposal income as inflation fades, after successfully passing on a large part of inflation to tenants via rent increases.

Most valuations have stabilized, except for nonprime offices, which we believe could continue to experience difficulties in 2025. Between June 30, 2022, and June 30, 2024, asset valuations of European REITs declined by about 10% on average (chart 6). We expect the European Central Bank (ECB) will cut its deposit rate to 2.5% by the summer of 2025, from 3.25% currently, and maintain that rate over the following two years. Therefore, we think long-term rates will remain stable and no longer affect property yields in the coming appraisals.

Chart 6

Reported devaluations are still within S&P Global Ratings' expectations

Valuation LfL growth since June 2022 for rated REITs in EMEA, reported versus S&P Global Ratings' assumptions, as of Sept 2, 2024



LfL—Like-for-like. Source: S&P Global Ratings.

On the other hand, rental growth expectations and capex requirements will increasingly determine valuation changes. We think nonprime offices, which face growing vacancy and renovation needs, will therefore continue to see further devaluations.

Acquisitions will increase in 2025. We believe improving funding conditions will reduce the risk of distressed sellers and leave buyers with more funding options. The wide repricing that most properties underwent in the last 24 months will likely reduce the bid and ask gap, as evidenced by lower discount between share price and net asset value (NAV). Transactional activity is an important consideration for real estate companies because it sets a benchmark for their portfolio valuations, which, in turn, affects their loan-to-value (LTV) ratios.

Transactions in Europe are recovering from the very low level of 2023, but they were still 41% below the five-year average in the first nine months of 2024, according to Savills Research. Large institutional investors that were constrained by allocation limits following commercial real estate (CRE) losses in 2022 and 2023 could make a comeback in 2025 as the situation improves.

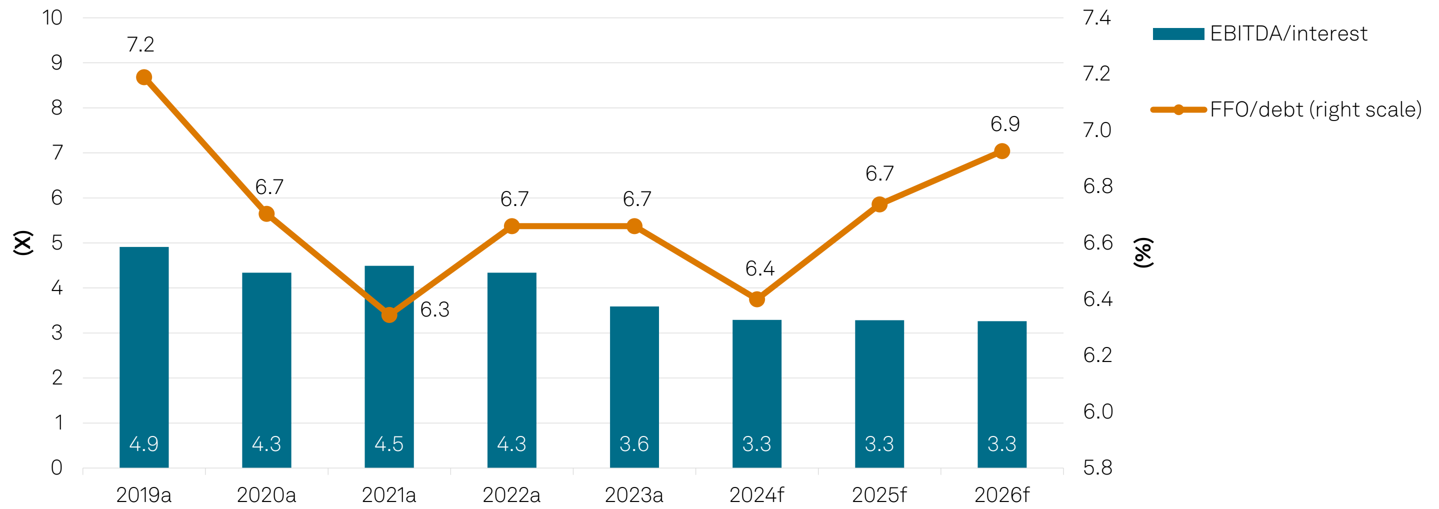
Credit metrics and financial policy

Interest coverage ratios (ICRs) will have bottomed out for 62% of issuers by the end of 2025. We expect average ICR will stabilize around 3.3x in 2025 from 4.5x in 2021 (chart 7). This is because companies' debt profiles are highly hedged or fixed with staggered debt maturities and lower absolute debt. Funding conditions are improving, with yields and REITs' spreads decreasing sharply since the beginning of 2024 ahead of likely rate cuts by the ECB. This is helping real estate companies refinance their debt maturities at more moderate rates than in 2023; it also benefits those exposed to variable rates.

Chart 7

ICR stabilizes, and FFO to debt improves

Average ratios for rated REITs in EMEA, as of Dec. 17, 2024



a—Actual. f—Forecast. Source: S&P Global Ratings.

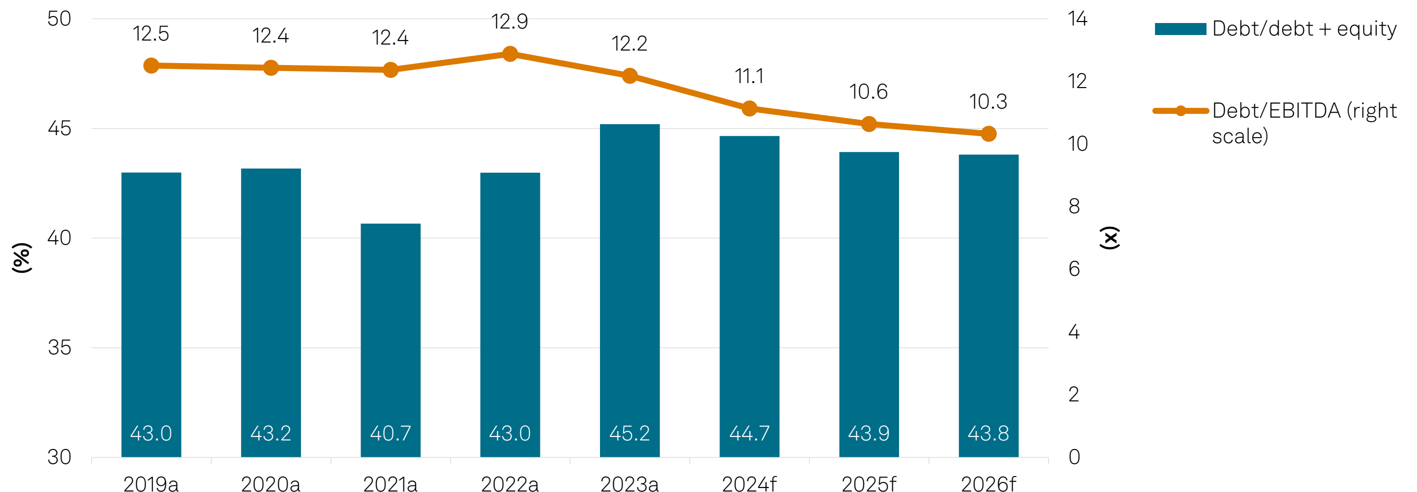
At the same time, rental income growth remains robust across most segments because of the lasting tailwinds from inflation indexation and the low supply. We therefore estimate that 47% of companies have already seen their ICR reach the bottom in 2024, and another 10% will do so this year. We anticipate the remaining 43% will see ICR bottom out in 2026 or later, though the pace of decline will be more moderate.

Debt to debt and equity will decrease by 0.5-0.7 percentage points (ppts) every year, on average, after peaking at 45.2% in 2023 (about 5 ppts higher than 2021; see chart 8). This is due to our expectations of stabilizing asset valuations and some deleveraging effects. Renewed appetite for investments as market conditions improve could temper the improvement in this ratio.

Chart 8

Both debt to EBITDA and debt to debt and equity should improve

Average ratios for rated REITs in EMEA, as of Dec. 17, 2024



a—Actual. f—Forecast. Source: S&P Global Ratings.

Debt to EBITDA will likely continue to improve because we expect revenue will continue to grow on a like-for-like basis and most debt-funded investments have been halted in recent years. We anticipate more free operating cash flow (FOCF) in 2024 than in the past five years.

Funds from operations (FFO) to debt is remarkably resilient despite rising funding costs. Robust rental income growth continues to offset more elevated interest burden, such that the ratio will likely increase steadily.

Key risks or opportunities around the baseline

1. Resumption of acquisitions and dividends may jeopardize deleveraging targets.

Some opportunistic transactions may arise for REITs, particularly for stronger players. Dividends could also resume following strong operating performance.

2. Geopolitical risks could delay the sector's recovery.

This could disrupt investors' appetite and affect government yields, which ultimately could limit asset valuations' recovery. Any negative impact to economic sentiment, job market, or consumption could also erode tenant demand.

3. Growing environmental requirements would weigh on capex.

Tighter regulation around properties' energy performance would require REITs to further increase renovations capex while the cost of capital remains high, and most REITs are still focused on deleveraging.

Opportunistic acquisitions and dividends could delay deleveraging targets. Following the weakening of LTV and ICR, REITs have been focused on deleveraging to comply with long-term ratio guidance. This mostly occurred through capex and dividend cuts.

However, the strong improvement of funding conditions and the stabilization of some REITs' capital structures could prompt companies to resume opportunistic acquisitions. Property yields have increased, and some well-funded acquisitions could even improve ICRs. Most companies reported strong operating performance lately, and revised their guidance upward, suggesting dividend distributions could normalize.

Geopolitical developments could delay the recovery of the property sector, by limiting investments. Increasing pressures on governments' budgetary decisions could also affect government bond yields. Higher yields due to perceptions of greater sovereign risk would, in turn, weigh on asset revaluations as property appraisers use these yields as risk-free rates in their property yield assumptions.

A more hostile and uncertain global environment could further erode Europe's economic security, weigh on consumer confidence, and bolster savings at the expense of consumption and growth. Stagnating growth would be detrimental to corporate credit performance and could imply lower demand for commercial real estate.

Growing environmental requirements could weigh on REITs' balance sheets. European REITs are progressing toward their decarbonization targets for this decade, but longer-term goals remain challenging and will involve significant investments. Buildings are responsible for about 40% of energy use in the EU, which aims to fully decarbonize buildings by 2050. The revised Energy Performance of Buildings Directive, which took effect in May 2024, will likely lead to a wave of renovations.

Industry Outlook: Asia-Pacific REITs

Ratings trends and outlook

The outlook on Asia-Pacific (APAC) rated REITs and real estate landlords remains predominantly stable (87% of the portfolio), which we expect will continue in 2025. That said, credit quality and ratings trends remain divergent across Asia-Pacific region. The region's divergent interest rates and vacancy trends, coupled with potential disruption from planned asset sales, could translate to continued pressure to credit quality.

The credit metric buffers of landlords and REITs remains thin. That said, credit metric deterioration is slowing, but subdued market conditions will delay meaningful improvement. REITs that embark on debt-funded acquisitions or fail to execute their asset divestment plans could see meaningful pressure to their credit metrics. Tepid asset sales, lower transaction activity, and slower U.S. dollar interest rate cuts could hamper landlords' asset sale plans. Credit metrics trends will remain divergent among different commercial asset classes.

Office landlords will face more asset value declines. Valuation pressures remain for major Australian cities and Hong Kong due to oversupply and weak tenant demand. Vacancy rates in Hong Kong could rise further into 2025 as supply remains ample. The higher-than-historical-average vacancy rates and limited financial buffer will hinder landlords' ability to grow and sustain the quality of their asset portfolio.

Main assumptions about 2025 and beyond

1. Refinancing risk remains manageable for landlords.

Banks remain supportive of prime commercial assets in key Asia-Pacific gateway cities, allowing landlords to refinance their debt with longer tenors.

2. Landlords consider all available capital-management levers to bolster credit metrics.

Asset divestments, distribution payout reduction, deferral of nonessential capex, and equity fundraisings are the most common capital initiatives employed by Asia-Pacific REITs to improve credit metrics and stave off rating pressure.

3. Vacancy rate of commercial office assets in key gateway cities could rise further.

Vacancy rate of commercial offices in key Chinese cities, Hong Kong, and Melbourne, Australia could deteriorate further through 2025.

Credit metrics and financial policy

Pacific: In 2024, office Australian REITs (AREITs) protected credit metrics through asset divestments and debt reduction. We expect these capital management strategies will continue in 2025, with further potential asset sales. We also expect companies will reduce distribution payouts, raise new equity, and access third-party capital. Signs of stabilization in asset valuations in Sydney—Australia's largest office market—and the likely moderation of increases in interest and capitalization rates in 2025, will likely support future asset sales. We note office landlords will seek to balance the undertaking of asset divestments with the potential adverse impact this would have on their asset portfolio's scale and competitive position.

Despite subdued consumer confidence and cost-of-living pressures, our rated retail landlords continued to report robust shopper footfall and retail sales in 2024. In 2025, we expect increased

consumer spending, real wage growth, and contained inflation will offset cost-of-living concerns. We forecast this will underpin continued retail growth, particularly in nondiscretionary segments and benefit retail AREITs. This has prompted the recent pickup in transactional activity as equity investors look to deploy capital in the sector.

We expect vacancy and incentive rates in the industrial sector will continue increasing in 2025, albeit from a relatively low base. Given subdued economic conditions, we expect retailers will more prudently manage inventory levels and space utilization in distribution warehouses. That said, we expect credit metrics of industrial AREITs to remain stable because they have a significant exposure to high quality, well located, and highly diversified industrial assets with long leases.

Hong Kong: We expect the credit metrics of rated REITs and landlords in Hong Kong will be pressured in 2025. Weak office leasing demand and rising supply will continue to further push up vacancy rates and suppress rents. The decline in retail sales is also contributing to weaker retail rents, pressuring landlords. Rated landlords are in a better position, because they own quality assets in prime locations with good diversification across office, retail, and hotel.

We do not expect any sizeable debt-funded acquisitions because owners will seek to sell assets to reduce debt levels. While interest rates appear to have peaked, they remain high relative to previous levels. As a result, we expect our rated issuers' interest coverage will slightly increase from 2024 levels. We believe our rated issuers will maintain lower dividend payouts and retain cash flow to meet their fixed obligations.

China: In general, office leasing demand is weak due to waning business confidence. Companies are reducing rents to limit vacancy levels. Office vacancy rates in key cities are at 20% or above as of September 2024, with Guangzhou's vacancy rate slightly lower at about 18%. The retail landlords are displaying some resilience, though slowing retail sales indicate more weakness in the coming year. As a result, we forecast Yue Xiu Real Estate Investment Trust's (BBB-/Negative) credit metrics will be constrained in 2025 despite its quality assets in tier-one cities. We also expect to see more asset divestments from the broader market. This could be through direct sales or setting up additional REIT platforms, encouraged by government policies. There will be limited appetite for acquisitions.

Japan: We expect the credit metrics of rated Japanese REITs (JREITs) and landlords will remain stable in 2025. As the supply of office space in Tokyo increases in 2025, we expect the improvement in central Tokyo's office vacancy rate to hover around 5%. The vacancy rate improved from 6.0% at the end of 2023 to around 4.5% in 2024. The average office rent increased in 2024 due to limited new supply and strong corporate performances. The performance of rated issuers will be supported by their high-quality, well-located portfolios, which we expect will remain resilient.

We expect retail store sales will grow steadily due to increased tourism. We also predict condominium rents will grow steadily following the return of population growth in Tokyo. This is also supported by higher condominium sales prices due to limited land supply and higher construction cost for condominiums.

Rated issuers will continue to fund investments through debt, equity, and proceeds from asset divestments to maintain credit metrics consistent with their financial policies. We expect strong interest-coverage ratios, long average debt durations, and a high proportion of fixed-rate debt for rated issuers to underpin their credit quality.

Singapore: We expect the credit metrics of most rated Singapore REITs (SREITs) to remain stable in 2025. This is supported by sound portfolio quality and our expectation that most REITs will

manage their debt usage in a prudent manner. That said, most rated SREITs have limited headroom for sizeable debt-funded asset acquisitions and enhancements.

We expect commercial office leasing conditions will weaken because rent has become stagnant amid higher vacancies. This is particularly true for older and lower quality offices. On the retail front, improving tourism activities will improve performance at downtown malls, though manpower shortages and high operating costs may limit retailers' ability to pay higher rents. Continued rise in business and leisure travel to Singapore will underpin higher occupancy and average room rates of hospitality assets.

Key risks or opportunities around the baseline

1. Landlords fail to monetize assets to deleverage on a timely basis.

Higher-for-longer interest rates in Australia could keep purchasers on the sidelines, stymieing landlords' efforts to deleverage. Sales of office assets at depressed prices will exert further downward pressure on office valuations.

2. Average funding costs stay high for longer, hindering recovery in credit metrics.

Landlords may face higher funding costs at the next fixed-rate debt reset. Faster-than-expected interest rate hikes in Japan and sluggish revenue increases could dent Japanese landlords' credit metrics.

3. Return-to-office-initiatives could improve office demand in the medium term.

This would increase physical office usage and ease the trend for tenants to downsize their space requirements. Australia would benefit the most in the region given their higher adoption of hybrid working.

Pacific: The ability of office AREIT landlords to execute on asset divestments in a timely manner is a key risk. With elevated interest and capitalization rates, office landlords are pursuing asset sales to reduce debt and shore up weakened credit metrics. Asset sales proceeds applied to debt reduction will repair the credit metrics but could also weaken the business risk assessments of office AREITs.

Beyond fiscal 2025, we forecast new developments will be limited across our rated office landlords as they balance higher construction costs and uncertain tenant precommitments. Landlords will need to balance asset divestments with a diminishing asset portfolio.

Hong Kong: A prolonged weakness in office leasing demand is a key risk for REITs and landlords in Hong Kong. Due to weaker-than-expected economic recoveries in Hong Kong and China, tenants may downsize their existing space requirements. This will make it difficult for the market to absorb the 7.9 million square feet of new, grade-A office space available by the end of 2026. Our rated issuers are responding to this surplus by offering smaller floor plate configurations to capture pockets of demand from insurance and asset management companies. They also continue to upgrade base building services to obtain green certificates to attract tenants. These improvements have helped them maintain low vacancy rate of below 10% relative to the industry average of above 13%.

Structural changes in Hong Kong's retail sector will present challenges for retail landlords. Retail sales are under pressure as tourist arrivals have yet to recover to pre-pandemic levels and Hong Kong residents are increasingly travelling overseas or across the border to China. Hong Kong retail sales have dropped by 7.6% in the first nine months of 2024 and the trend is unlikely to improve.

China: We expect office REITs and landlords in China will face pressure as the uncertain economic outlook in China weighs on business sentiment. Potential higher trade tariffs on China's imports to the U.S. is adding more uncertainty and will likely suppress economic growth. As a result, office leasing demand will remain weak, which will pressure rent and vacancy levels over the next year. However, issuers will be resilient because their assets are in tier 1 cities with less new supply.

Slowing retail sales could be another risk, and a rising number of shopping malls will lead to more competition for tenants.

Japan: Larger-than-expected interest payments, operating costs, and capex among Japanese REITs would decrease profitability; increasing net operating income and improved occupancy rates would not be able to offset the effect. It would also undermine rated issuers' portfolio asset values and reduce their interest coverage ratios.

Because rated landlords are focusing on profit growth and improving capital efficiency, more aggressive investments or shareholder returns could increase their debt burden relative to cash flow, and financial buffers would be thin. Rated landlords could see higher volatility in earnings if their real estate development and sales business contributes more to their profits.

Singapore: Rated SREITs could seek to expand their portfolio or pursue asset enhancement initiatives to upgrade their portfolio quality. Investments could be funded by asset recycling, on an opportunistic basis, or with debt. Debt-funded growth will stress credit metrics. While REITs can decrease leverage with asset sales, execution risk can delay or limit balance sheet repair.

Industry Outlook: Latin America Real Estate

Ratings trends and outlook

The outlook on Latin American (LatAm) rated real estate operators remains predominantly stable (78% of the portfolio), which we expect will continue in 2025. We expect a relatively stable operating environment for REITs, with decreasing interest rates in most countries, except for Brazil, although our current economic forecasts consider a slowdown in consumption and investment in the region.

Trade uncertainty threatens growth, especially for industrial portfolios in the region. This could stall the nearshoring trend, which incentivized higher capital expenditures and acquisitions. Though an increase in trade protectionist policies by the U.S. poses a downside risk to our projections, our base case assumes no new tariffs on LatAm. Funding needs for industrial operators will likely decrease, although financing is available and committed in most cases.

We expect retail portfolios will perform relatively well due to resilient consumption trends, and office properties are slowly gaining back occupancy after high vacancies during the COVID-19 pandemic. We expect this trend will continue, although our rated portfolio in the region has little exposure to office properties. We believe that retail and office operators' funding needs will be low, like last year, given the absence of significant gross leasable area (GLA) growth in these asset classes.

Main assumptions about 2025 and beyond

1. U.S. trade protectionism will discourage growth.

Though we assume no tariffs for LatAm countries, we expect news headlines will stall demand, especially for industrial assets, which are mostly geared toward manufacturing of goods for export.

2. Office properties have bottomed.

Office properties have high vacancy rates of close to 20% (roughly double pre-pandemic levels); however, we expect some improvement in 2025 as some businesses bring employees back to the office.

3. Moderate rental income growth for retail properties.

We expect occupancy rates for retail properties will modestly grow in 2025 because these assets have almost fully recovered to levels within 90%-95%. We estimate rental income will continue to grow, at uneven paces within the region.

Trade uncertainty will lead to lower growth and some deleveraging. We do not anticipate universal tariffs by the U.S., or changes to the United States-Mexico-Canada Agreement (USMCA) before the scheduled July 2026 review. However, we believe news headlines will discourage new investments in the region, making development pipelines more selective. We expect this will translate to lower financing needs and modest deleveraging.

We estimate acquisitions and capex will decline in 2025 for Mexican entities, following a strong expansion in 2024. These were funded with a mix of debt and equity, leading to a relatively neutral credit impact on the companies. Moreover, for new properties, we expect a stabilization period will lead to high-single-digit percent EBITDA growth. We also expect some noncore asset

divestments due to high industrial property valuations, with proceeds used mostly to pay down debt.

Portfolio growth in Brazil will mostly come from industrial portfolios because we forecast a greater reliance on debt to finance development projects in 2025. However, we expect incremental leverage will be moderate, largely offset by rental income and EBITDA growth, supported by stronger operating indicators.

Rental income for retail assets will grow at uneven paces. With the increasing adoption of e-commerce among Brazilian consumers and retailers, we anticipate these entities will achieve average revenue growth in the high-single-digit percent. This contrasts with expectations in Mexican and Peruvian entities, where we expect revenue will grow 0%-5%, given lower inflation, slow consumption, and little GLA growth. However, because roughly 90% of rental income comes from fixed rent agreements, we don't anticipate a sharp contraction even if consumption drops.

Most financing activities will be related to rolling over existing debt. The weighted-average debt maturity profile of the LatAm portfolio is close to four years, with short-term debt maturities comprising around 10% of total debt. Access to capital remains fluid, resulting in very low refinancing risks. Moreover, although we expect interest rates will continue to decrease, financing costs remain above levels from two to three years ago. Nonetheless, we expect coverage ratios will modestly improve, because we estimate EBITDA growth will outpace pro forma refinancing costs.

Credit metrics and financial policy

We expect deleveraging during 2025 and steady coverage ratios. Industrial REITs deployed relatively high levels of capital in 2024, using debt and equity proceeds to fund development projects and acquisitions. We expect lower activity in 2025. Stabilization of newly constructed properties and asset divestments from acquired large portfolios will likely lead to deleveraging of rated entities in Mexico.

In Brazil, we expect some debt-funded developments in industrial assets, though we expect rental income and EBITDA growth will offset incremental debt. For retail and office portfolios, we expect an improvement in rental income, mostly among Brazilian entities, which don't have major projects in the pipeline, thereby keeping leverage metrics relatively stable.

On average, we expect rated LatAm real estate entities will maintain solid credit metrics for 2025, with debt to capital of 30%-35%, EBITDA interest coverage of about 3.9x, net debt to EBITDA in the 5.0x-6.0x range, and funds from operations (FFO) to debt of about 20%-25%.

Key risks or opportunities around the baseline

1. More aggressive U.S. protectionist measures will slowdown nearshoring.

The incoming U.S. administration has been vocal on potentially imposing tariffs on Mexico, Canada, and Brazil, which would impact industrial portfolios in the medium term.

2. Reflation concerns grow in Brazil.

Fiscal risks facing Brazil may impact the profitability of retail portfolios through erosion of purchasing power.

3. Geopolitical risks remain high, looming over global supply chains.

The geopolitical climate supports the relocation of supply chains, in favor of regional manufacturing hubs. This remains an opportunity for LatAm, especially Mexico, given its closeness to the U.S. consumer end market.

Crosscurrents at industrial assets. The current baseline scenario is that the U.S. won't impose tariffs on imports from LatAm countries. Nonetheless, we acknowledge the high level of uncertainty. The risk of any type of tariff materializing, even if only temporary, is a significant demand headwind for industrial assets. This is especially true in Mexico, where there are large industrial portfolios completely integrated within supply chains that produce goods for the U.S. market. Moreover, although we don't expect an immediate effect in outstanding lease agreements, potential renegotiations or terminations are a clear knock-on effect for real estate operators.

In our view, this uncertainty will take a toll on the development pipeline until there's more visibility on the U.S.-Mexico trade front. However, we'd expect the short-term impact to be relatively mild because most of the rated portfolio has lease agreements beyond three years, sometimes close to 7-10 years and largely dollarized, reducing any risk from further MXN-USD exchange rate depreciation. However, the imposition of tariffs has the potential to decrease occupancy rates in the medium term.

The reshoring of supply chains is an opportunity for Mexico. The need to reshore closer to the U.S. end market has increased over the past years, given global supply chain disruptions, geopolitical conflicts, and the U.S.-China decoupling. This strongly positions Mexico to continue capturing some of these investments. In the past two years, we've seen lease spreads around 20% on an annual basis (30%-40% in premium locations), while occupancy rates remain around 98% and with several sold-out submarkets in northern Mexico, reflecting high net absorption rates.

As businesses navigate these crosscurrents—balancing tariff-induced challenges with the strategic advantages of regional manufacturing—the outlook for industrial real estate assets in Mexico and LatAm remains complex for 2025. We expect greater financial prudence regarding the use of debt and capital deployment this year.

Fiscal risks facing Brazil may exert upward pressure on the country's inflation. This could negatively impact the purchasing power of the Brazilian population, posing a risk to retail portfolios, because declining sales tighten retailers' capacity to cover operating expenses—such as leases—heightening the risks of default and vacancy. Despite macroeconomic challenges, companies have intensified their investments in the expansion and revitalization of certain assets in recent years. Additionally, they own premium assets and have focused on enhancing service offerings and events in their shopping centers, which improved the attractiveness and quality of these assets, thereby partially mitigating macroeconomic risks.

Industry Outlook: Other Regions

Gulf Cooperation Council (GCC)

The outlook for this region remains positive despite escalating conflict and potentially declining oil prices. A key reason is increased government spending; for example, Saudi Arabia is implementing Vision 2030, which carries sizable upfront costs, but the country expects it will lead to longer-term social and economic benefits. In the United Arab Emirates (UAE), the governments continue to invest in infrastructure, tourism and entertainment, and regulation. Qatar, by contrast, is still dealing with excess supply across all real estate segments.

Saudi Arabia: We forecast economic growth, which benefits from strong non-oil growth that compensates for softening oil prices. Given the high level of government spending, there are opportunities for international businesses and services to enter the Saudi market. Therefore, the office segment is experiencing robust demand, with year-over-year rental growth of 11%-18% and low vacancy rates in Riyadh and Jeddah. We expect new supply in 2025 will be 10% of current stock, which will likely ease rental rates in the next 12 months.

Tourism comprises about 4% of GDP and has significant potential for growth. With easing of visa norms and expanding entertainment and sports events, we expect the country's hospitality sector will thrive. However, the retail real estate segment is struggling given changing consumer preferences to e-commerce and omni-channel shopping. While Riyadh's malls posted stable rents and vacancy below 5%, other parts of the country experienced a mixed performance. We expect future stock will be disruptive to the market as older and simpler offerings will be replaced by those with a better asset quality and shopping experience.

United Arab Emirates: We forecast strong GDP growth in 2025; 3% for Dubai (unrated), 5% for Abu Dhabi (AA/Stable/A-1+), 4% for Ras Al Khaimah (RAK, A/Stable/A-1), and 2.7% for Sharjah (BBB-/Stable/A-3). Dubai continues to be a favorite for international investors. RAK is gaining significant momentum due to the construction of the Wynn Al Marjan Island (WAMI) integrated resort (expected to open in 2027), which was awarded a commercial gaming operator's license—the first to be granted in the UAE. This has spurred hospitality projects and residential and service apartments projects in the emirates.

Dubai's overnight visitors increased to 14.96 million for year-to-date October 2024, which is 8% growth compared to the prior year period. This supports the hospitality and retail sector given Dubai's reputation as a shopping destination. Luxury retail in Dubai experienced disproportionate growth, as did the super-regional malls that house the brands. Regional malls that cater to domestic needs had stable rents. We expect this trend will continue in 2025; however, with no major supply expected, we could also see some small growth for regional malls.

Rental growth in the office segment in Dubai is increasing by mid-teens percent and by 9%-11% in Abu Dhabi. We expect economic opportunities, UAE's reputation as a safe haven within the GCC, and its low tax regime will sustain its attractiveness for global investors. Office vacancy is about 5%, which is lowest it's been in several years. However, we expect some new stock will enter the market and increase competition.

Qatar: The real estate market slowly recovered in 2024 from the correction related to oversupply created for the World Cup in 2022. The office segment continues to be supported by government-related leases while retail real estate struggles despite significant growth in food and beverage (F&B). Rentals rates have been stable over 2024. We do not expect significant recovery over the next 12-24 months.

Israel

Ongoing political and geopolitical risks are weighing on the credit quality of Israeli real estate companies, as evidenced by the substantial increase in negative outlooks, which increased to 20% from 10% in 2022. The Israel-Hamas war has weakened the country's high-tech industry, which drives demand for domestic office space. This has been exacerbated by the domestic economy's slowdown, an increase in office supply, and work-from-home trends; all of this contributed to a decline in demand for office space, lower rent levels for new contracts, and a mild decrease in occupancy rates, even in Tel Aviv, which previously saw record prices and occupancies.

Currently, these factors do not have a significant impact on the occupancy rates of rated real-estate companies, which mainly operate in high-demand areas with high-quality properties and a strong, diverse tenant base. In fact, office real estate companies have generally reported an increase in net operating income (NOI), primarily because of long-term contracts that are price indexed and result in relatively stable occupancy rates. However, filling new properties is proving difficult, especially in less central locations.

We anticipate increasing pressure on rent levels and occupancy rates due to our revised, weaker macroeconomic forecast for Israel. Additionally, we expect new, high-quality office space in the coming years will further erode rental rates and occupancy, particularly in areas already experiencing oversupply.

Strong growth in the turnover of shopping center tenants supports the performance of retail real estate companies. Despite the ongoing war, the leading companies in the sector reported significant growth in shopping center tenants' revenues, ranging from 9%-12% during the first nine months of 2024. This contrasts with modest growth of about 2% in 2023, following the disruption in the fourth quarter from the outbreak of the war.

The CPI-linked rent contracts have also supported solid operating performance, with companies in the retail sector growing 2%-6% in same-property NOI and maintaining very high occupancy rates. However, there are increasing risks of a slowdown in consumer spending due to expected tax increases, budget cuts, and weaker macroeconomic performance. These factors could reduce tenants' profitability and eventually erode rental rates.

Pressure on real estate companies' profits continues as interest rate cuts are delayed due to inflation. In the first nine months of 2024, most income-producing real estate companies reported positive revaluations due to rent increases. These revaluations were largely influenced by CPI, but also reflected a real rise in rents. However, we expect high interest rates will persist at least through the first half of 2025, increasing the risk of asset devaluations. Still, we do not anticipate asset devaluations for our rated companies, given rent indexation and the high quality of assets in central locations. If devaluations occur, they are likely to be more significant for low-quality assets or those in less-central areas, where pressure on occupancy rates and rents is higher.

Related Research

- European Real Estate Companies: Not Yet Fixed, But Improving, Jan 9, 2025
- Real Estate Brief: How Political And Geopolitical Risks Could Affect European Commercial Real Estate, Dec. 18, 2024
- EMEA Office REITS: How Credit Stories Have Evolved, Dec. 17, 2024
- U.S. Office Real Estate Investment Trust (REITs) Portfolio How Credit Stories Have Evolved, Dec. 11, 2024
- FAQ Examines Whether Operators Can Navigate Pitfalls In Asia-Pacific's Data Center Boom, Sep, 17, 2024
- Build To Rent: A Credit Perspective On Australia's Housing Future, Jul, 21, 2024
- Most European REITs Valuations Should Bottom Out In 2024, July 10, 2024

Industry Forecasts: Real Estate

Chart 9

Debt to capital (adjusted)

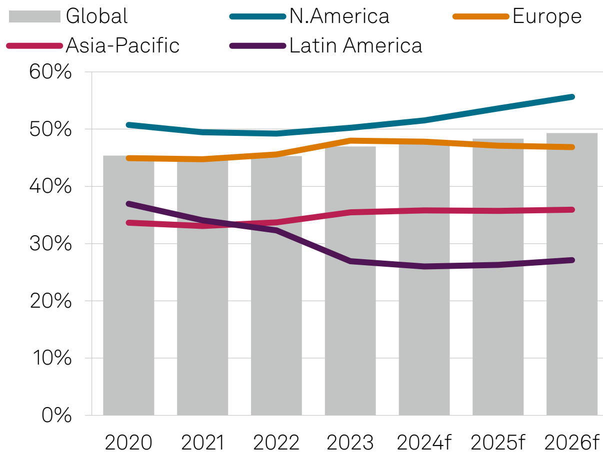


Chart 10

EBITDA interest coverage (adjusted)

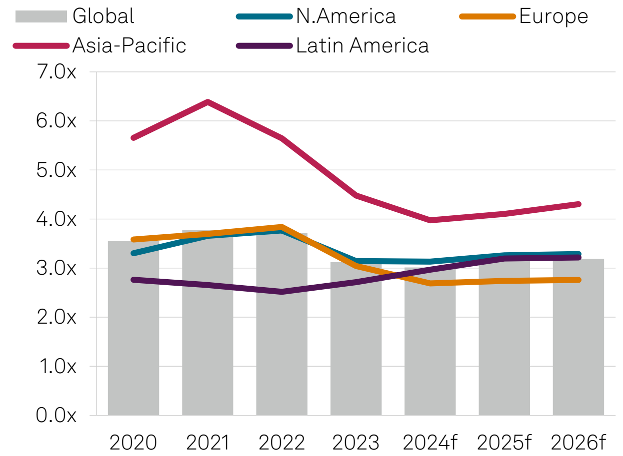


Chart 11

Debt / EBITDA (median, adjusted)

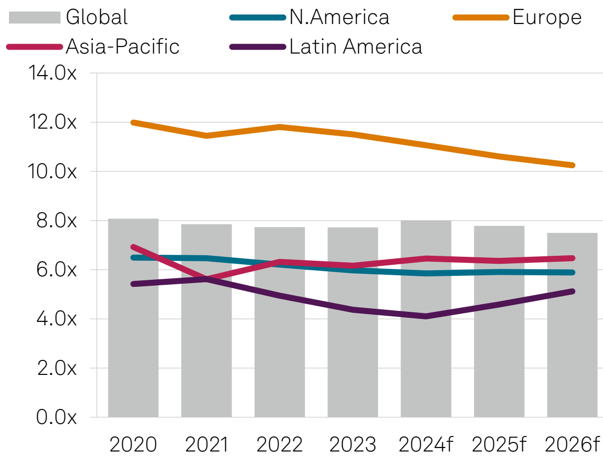
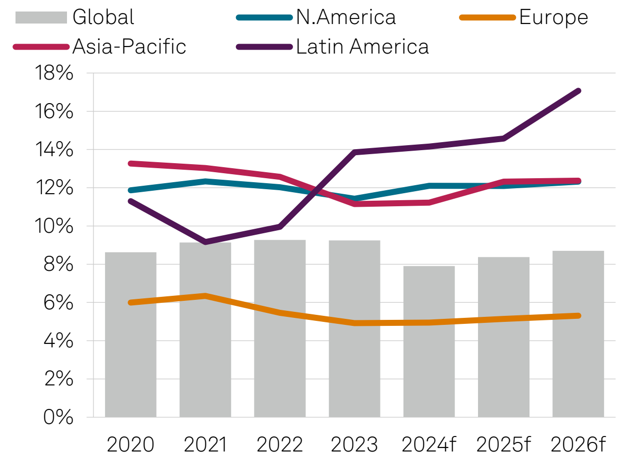


Chart 12

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
All data converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Real Estate

Chart 13

Rental revenue growth

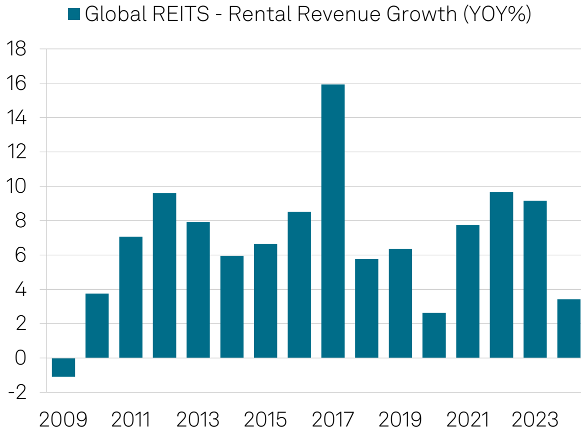


Chart 14

Return on capital employed

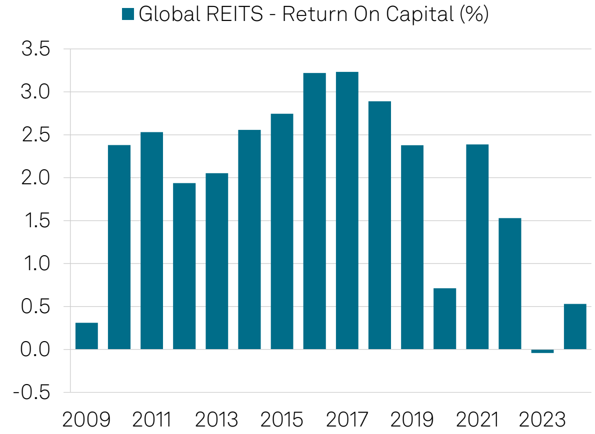


Chart 15

Fixed- versus variable-rate exposure

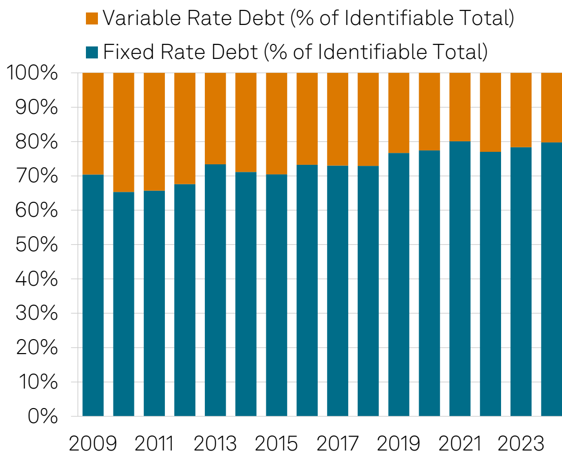


Chart 16

Long-term debt term structure

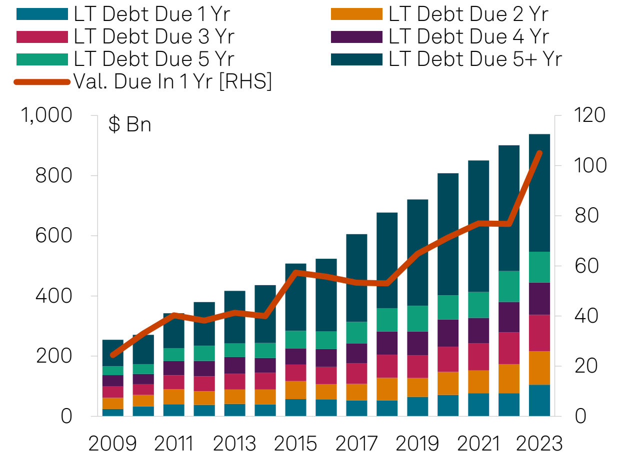


Chart 17

Cash and equivalents / Total assets

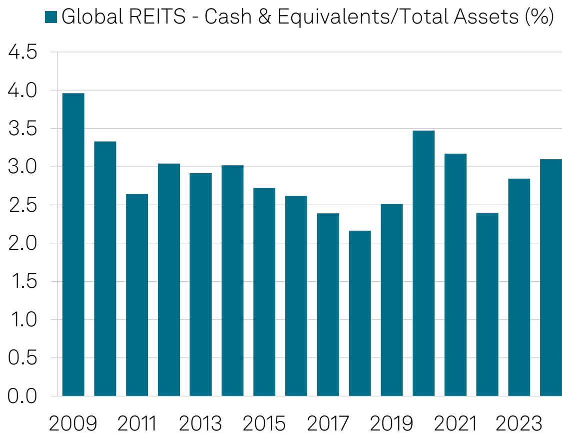
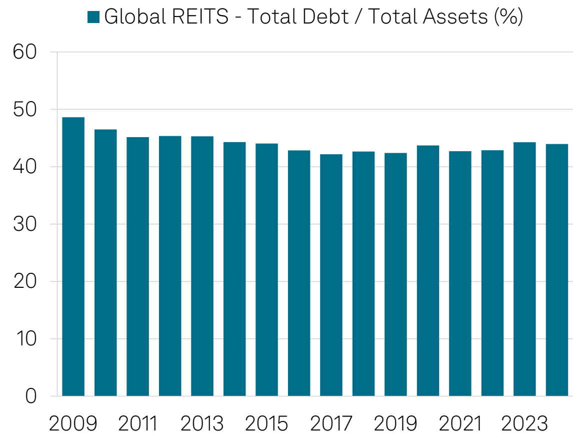


Chart 18

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2024) figures use the last 12 months' data.

Copyright 2025 © by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&Ps opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge) and www.ratingsdirect.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/ratings/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.