Homebuilders and Developers

Tariffs will test the foundation

January 14, 2025

This report does not constitute a rating action.

What's changed?

Prices of raw materials remain high. European cement remains 40% higher today versus 2021. Despite the higher cost base, construction activity and economic growth in Europe remains high.

U.S. mortgage rates remain high despite two federal rate cuts. The 30-year fixed rate mortgage began the year at 6.6%, was 7.2% in May, and is 6.8% at the end of November.

What are the key assumptions for 2025?

High home prices and higher than expected mortgage rates are pricing many U.S. buyers out of the market; the share of first-time homebuyers has declined sharply.

China's primary property sales will decline by 4%-6% in 2025, primarily due to increasing inventory levels and market-driven pricing.

Brazilian builders manage debt and reduce leverage thanks partly to increased cash generation and the Minha Casa Minha Vida program.

What are the key risks around the baseline?

New trade policies in the U.S. Higher tariffs on Canada and Mexico and mass deportations of undocumented immigrants could increase costs for materials and labor. Higher tariffs on China could slow its economy, causing land developers to slow their investments.

Geopolitical risks could disrupt supply chains or increase investor risk-aversion and ultimately undermine homebuilders' and developers' margins and demand.

High interest rates in Brazil may pose risks to the financial health of the Brazilian homebuilder sector, restricting access to savings-funded mortgages and increasing debt servicing cost.

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Ratings Trends: Homebuilders and Developers

Chart 1

Ratings distribution

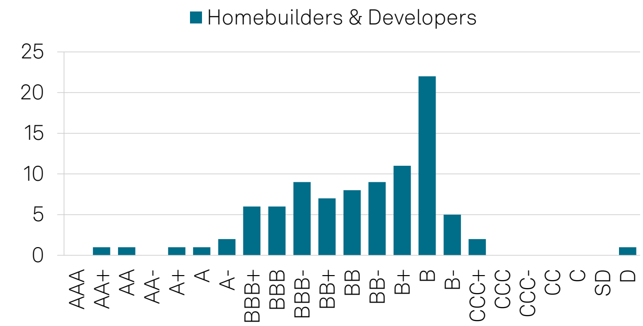


Chart 2

Ratings distribution by region

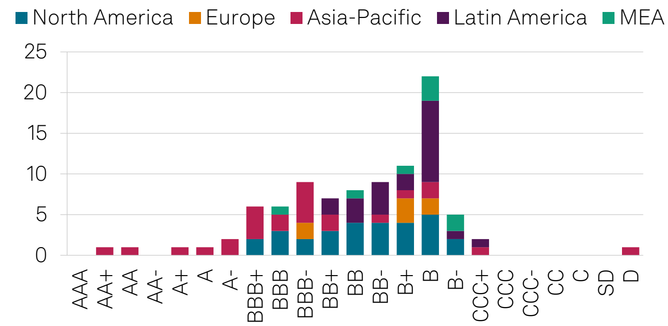


Chart 3

Ratings outlooks

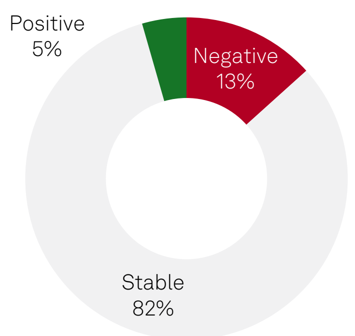


Chart 4

Ratings outlooks by region

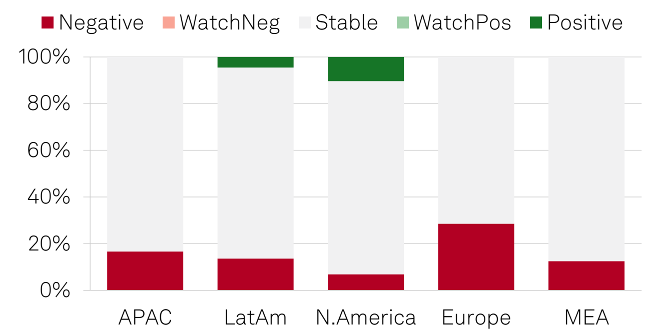


Chart 5

Ratings outlook net bias

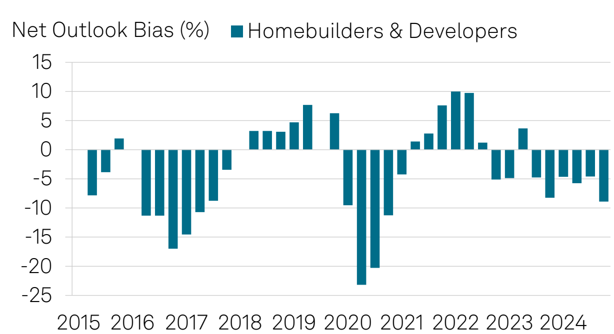
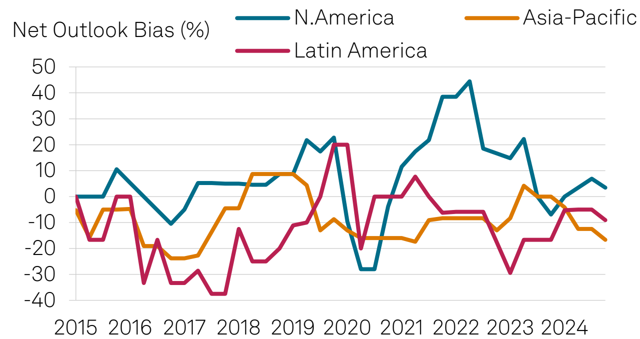


Chart 6

Ratings net outlook bias by region



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

Industry Outlook: U.S.

Ratings trends and outlook

S&P Global Ratings' overall outlook for the U.S. homebuilding sector is stable. Of the homebuilders and developers we rate, 83% have stable outlooks, 10% have positive outlooks, and 7% have negative outlooks. This means we currently expect about five rating changes over the next 18 months, probably three upgrades and two downgrades. For contrast, in 2024 we upgraded eight credits (28% of our rated universe), revised outlooks on seven, placed MDC Holdings on CreditWatch with positive implications, and began rating Landsea Homes Corp.

Despite our stable outlook on the sector, it benefits from good long-term demand, tight supply, low existing home inventory, a healthy labor market, good cost management, and thoughtful capital allocation. Many builders used the windfall from peak operating performance in 2022 to reduce debt and bolster land holdings to improve their balance sheets.

As of Jan. 1, 2025, we publicly rate 29 issuers in the U.S. homebuilding and real estate developer sector. Issuers' revenues range from $595 million to slightly over $35 billion. Currently 24% of our ratings on U.S. homebuilders and developers are investment grade (‘BBB-’ or higher) while 38% are in the ‘B’ category. Of our rating outlooks, all except five credits are stable. The New Home Company Inc, PulteGroup Inc., and Toll Brothers Inc. are all on positive outlook with LGI Homes Inc and Adams Homes Inc. on negative outlook.

Main assumptions about 2025 and beyond

1. Affordability challenges for first-time homebuyers persist.

The share of first-time homebuyers has declined sharply while the median homebuying age for this group has risen sharply.

2. Higher-than-expected incentives due to higher-for-longer mortgage rates.

Customer incentives help builders maintain their sales pace but also pressure profitability. If the level remains higher than normal, we could see a further decline in gross margins.

Affordability remains an issue. High home prices and higher-than-expected mortgage rates are pricing many buyers out of the market. The share of first-time homebuyers dropped to 24% in 2024, the lowest since 1981, when the National Association of Realtors started tracking the metric. From 1981 to 2008 the share of first-time buyers averaged 40%. In addition, the median first-time homebuyer age has increased to about 38 years old from about 33 right before the pandemic. If the proportion of first-time homebuyers to all-home sales continues to shrink, we would expect it to have long-term implications for those builders who are focused or have adjusted their focus to the entry level product.

Mortgage rates have remained high despite two rate cuts in 2024. The 30-year fixed rate mortgage began the year at 6.6%, peaked at 7.2% in May, and was 6.8% at the end of November. Homebuilders that offer a rate buy-down incentive were able to mitigate those higher mortgage rates for customers. This, in addition to reducing the size of homes to be sold, provided better affordability for customers and a steady sales pace for homebuilders and developers.

However, these incentives have resulted in a decline in profitability, and we expect gross margins, on average in our rated universe, to decline to 23.9% in 2025 from 24.7% in 2024. S&P Global economists currently expect 30-year fixed mortgage rates of 5.9% for 2025. As the rate sinks, we expect fewer of these incentives to be offered, aligning to pre-pandemic levels. All else the same, this could help stabilize margins.

Credit metrics and financial policy

Financial discipline before and during the pandemic yielded stronger ratios and a growing credit buffer for most homebuilders and developers, indicating their credit quality improved. We expect most issuers in the sector to sustain solid credit protection measures with robust profitability and lower debt levels, given the aforementioned buffers and the continued improvement in construction cycle times. Since the global financial crisis, builders pivoted to a focus on returns over profitability. Since the pandemic, incentives and cost inflation are causing gross margins to decline, although not by much, relatively; 2019 gross margins for our rated universe were 18.7%, compared to 2024 margins of 24.7%.

While leverage for the sector is lower than before the pandemic, it does not necessarily mean broad-based higher ratings. Our assessment of each credit's financial risk incorporates leverage, but the rating also incorporates our assessment of each credit's business risk, which has remained relatively steady. We did upgrade 28% of our rated universe during 2024 as some higher-rated credits took market share; however, we still do not see homebuilding as an investment-grade sector. At least not yet.

We still see mergers and acquisitions (M&A) as opportunistic and view it on a case-by-case basis, but note that M&A activity has increased over the past three years. Noteworthy is the acquisition of MDC Holdings by Sekisui House, a foreign buyer with a low cost of capital, further expanding its exposure in the U.S. market.

Key risks or opportunities around the baseline

1. New administration's policy of mass deportations could increase labor costs.

Undocumented workers make up an estimated 13% of the U.S. construction industry and any loss of that workforce would probably drive up the cost of wages.

2. Proposed tariffs could increase the cost of materials.

Canada, which now has a tariff of 14.54%, could face a tariff of 25% under the Trump Administration. Softwood lumber, used to frame buildings, often comes from Canada. Both Mexico and Canada export gypsum, which the U.S. imports to make drywall, and cement. The U.S. is also the world's top importer of iron and steel, vital housing materials. Higher tariffs on these countries would lead to higher costs.

3. Existing home inventories increase from low levels.

If mortgage rates decline enough for existing homeowners to feel confident to sell, the increase in existing home inventories could siphon sales from prospective new-home buyers.

Mass deportations would lead to higher labor costs. Any large-scale and quick deportation actions by the new administration would significantly reduce the labor supply for construction trades. Undocumented workers make up an estimated 13% of the construction industry—more than twice that of the overall workforce, according to a recent estimate from Pew Research Center. The loss of the immigrant workforce would drive up the cost of wages for some positions and leave others unfilled. Even one particular trade being disproportionately affected because of a concentration of undocumented workers (such as roofers) would impact the entire home construction cycle.

In such a scenario we would expect the larger, better capitalized builders to be hurt less, to better absorb the higher costs, and possibly to increase market share.

Any additional tariffs on Canada and Mexico could increase construction costs. Nearly 10% of building materials used in residential construction are imported, according to the National Association of Home Builders (NAHB), and lumber from Canada probably accounts for the bulk of it. Canadian softwood lumber, used to frame buildings, now has a tariff of 14.54%. Currently the new administration is proposing up to 25% tariffs on Canadian and Mexican goods. In most cases, we would expect homebuilders and developers to pass along these costs increases to consumers.

The U.S. is also the world's top importer of iron and steel, essential housing materials, with about a quarter of America's $43 billion in imported iron and steel coming from Canada as of 2022. That same year, the U.S. imported $512 million of cement from Canada and $254 million from Mexico. Gypsum, which is used to make drywall, is also imported from both countries and has already jumped nearly 50% in price since 2020, according to the NAHB.

Less resale competition generally increases the buyer pool for new homes, and we believe this will persist while interest rates remain elevated. Currently one-third of housing inventory is new construction compared to historical norms of a little more than 10%, according to the NAHB. Combined with the slowdown in new home construction starts over the past several quarters, this has only increased the housing deficit. The lock-in effect—in which existing homeowners do not list their homes due to their below-market mortgage rates—is compounding the limits on the resale market. About 76% of homeowners with a mortgage have a fixed rate below 5%, according to John Burns Research and Consulting, with current market rates of about 6.8%. The lock-in effect provides strong support for the new home market and has resulted in market share gains for publicly traded homebuilders. If mortgage rates decline enough to allow existing homeowners to feel confident to sell, the increase in existing home inventories could siphon off sales from prospective homebuyers who see existing homes as more affordable than newly built. There is evidence that this has already begun in Texas and Florida, two of the fastest growing U.S. states by population growth.

Industry Outlook: EMEA

Ratings trends and outlook

We continue to expect credit rating pressure for European homebuilders and developers as illustrated by the 33.3% of negative outlooks (or two issuers out of six). The European market has been particularly hit by rising interest rates as the share of mortgage rates in developers' sales is generally higher. However, easing inflation and mortgage rates will help stoke housing demand. A strong and resilient labor market should also help restore homebuyer confidence.

Main assumptions about 2025 and beyond

1. Prices and volume should pick up as mortgage rates ease and purchasing power grows.

Demand for newly built residential should benefit from improving affordability and benefit to homebuilders and developers' sales.

2. Two-speed market, with Spain leading the pack.

European homebuilders are not performing equally across countries, with those most exposed to mortgage sales lagging.

3. Margin will recover gradually as construction costs remain elevated.

Cost of construction has eased but quite moderately and should continue to weigh on developers' margin in 2025.

Labor market resilience, rising purchasing power, and cheaper credit should boost demand for newly built residentials. The European Central Bank (ECB) has lowered its policy rates, which has triggered lower mortgage in most European countries. We expect the ECB deposit rate to reach 2.5% by mid-2025 and remain at this level toward 2027 (versus 4.0% in 2023). We believe long rates should remain broadly at the current level toward 2027. Real estate affordability should improve from a year ago, allowing developers to launch more projects and increase volumes. Most European countries should benefit from resilient job markets and higher disposable incomes, which would support the demand for new housing.

The market remains two-speed, with a longer recovery in France. This is due to the end of a government tax incentive and budget woes that are impeding potential support for property developers. For Spanish developers, we see a brighter trajectory. The country enjoys lower exposure to mortgage loans and higher demand from international investors, particularly on coastal areas. Spanish developers have shown greater resilience in passing on inflationary pressures to final buyers through price increases, despite rising interest rates. This has allowed them to protect profitability and production volumes.

We expect the cost of building materials to remain high, despite easing from high price increases in the past 18 months. Prices for raw materials, such as cement, increased 40% in 2022 and remain 40% higher today versus 2021. Despite this, construction activity remains high, fueled by recovery of public infrastructure projects financed through Next Generation European (NGEU) Funds and economic growth in Europe. This supports demand for raw materials, which maintains currently high prices, and we expect them to remain around current levels over the next two years. This could continue to affect developers' profits and consequently their credit profiles.

Credit metrics and financial policy

Revenue should recover in 2025-2026, after a strong decline in 2023-2024 thanks to higher sales in value and volume. EBITDA margins should improve gradually due to slowly easing construction cost inflation. Debt to EBITDA and funds from operations (FFO) to debt should recover in 2025 as more projects materialize and generate proceeds for recently taken out debt. EBITDA to interest should increase slightly thanks to revenue growth, albeit remain lower than 2020-2021 levels on average given the more elevated interest environment.

Key risks or opportunities around the baseline

1. Geopolitical risks could delay the recovery.

Geopolitical risks could lead to supply chain disruptions or stoke investors' risk aversion and ultimately undermine homebuilders' margins and demand.

2. Support from governments could help.

Any governmental attempt to revive housing demand, either through household incentives or large orders, will benefit property developers.

3. More environmental requirements.

While these are fueling demand for new builds, the requirements also represent additional costs, administrative hurdles, and technical challenges for developers.

Geopolitical instability remains our top risk in Europe. Even if political pressure from the new U.S. administration eventually leads to a wind-down in hostilities, the risks are enormous. Event risk could stoke investor risk-aversion, disrupt supply chains, and undermine the cohesion within NATO while shifting European governments' spending priorities. In such event, homebuilders could face shortage of materials, delays, and rising cost of constructions that could put their margins under pressure. Uncertainty and risk aversion would undermine demand, notably if rates were to increase. Lastly, any government budgetary constraint induced by a shift in spending could further reduce the likelihood of support to the real estate sector.

Government interventions could help correct the supply-demand imbalance. We continue to observe minimal support to the sector, unlike historically. In France the dismissal of the Pinel scheme—the last version of a long-dated tax incentive to buy newly built residentials—will end in 2025. There is a growing housing agenda in Europe, including the U.K. government's plan to build 1.5 million homes in five years, by setting housing targets for councils, streamlining planning, and incentivizing homebuilders. However, the tough market conditions (namely elevated interest rates and construction costs) and governments' tight budgetary headroom remain important constraints to provide more support to the sector.

Environmental requirements could be an opportunity or a risk for developers. As regulations become more restrictive toward low-energy-efficient housing, such as through minimum energy performance certificate (EPC) standards, they encourage the purchase of new builds that are typically more energy efficient and safer than aging or second-hand residentials.

However, these requirements may also delay the execution of projects and pile on costs to developers. Restrictions on building permits to limit land artificialization may also constrain the launch of new developments in coming years, especially in Western Europe.

Industry Outlook: Other EMEA

Gulf Cooperation Council

Dubai real estate had a tremendous year with presales poised to beat the record for 2023. Off-plan sales amounted to $34.3 billion in the first half 2024, on track to exceed $58.3 billion in full-year 2023. Dubai's resident population increased to 3.7 million at year-end 2023, and we project it will reach 4.0 million by 2026 on the back of an increasing number of expatriates and high net-worth individuals moving to the country. We expect Dubai's economy will remain relatively resilient and real GDP growth will remain close to 3.0% on average over 2024-2027 (3.3% in 2023).

The government's economic agenda, D33, aims to attract more investments in real estate alongside investment reforms and supportive regulations for businesses, boosting Dubai's real estate market. Dubai's dynamic economic environment, its reputation as a safe haven, and the low tax regime sustain the emirate's attractiveness for global investors.

We therefore expect primary property prices will remain stable over the next 18 months and to decline in 2026 due to significant potential supply pipeline. We expect sales prices per square foot in the primary market will remain stable in 2025 as developers focus more on increasing sales volumes rather than price growth. The share of luxury developments will likely reduce in 2025 since developers will continue to focus on affordable and mid-market properties and even the pace of new launches will decrease over the next 12-24 months given the market may not be able to absorb similar inventories as 2024. Against this backdrop we expect our ratings on developers will remain resilient in a weaker market environment due to reduced leverage, strong cash flow generation, and good liquidity buffers.

So far, the escalation of geopolitical conflicts in the Middle East has had no significant effects. Historically, the UAE—including Dubai—benefited from regional conflicts as they are considered a safe haven. This even led to population growth and investment inflows. The current conflict, however, is more complex and unpredictable than previous ones, in our view. It's liable to persist well into 2025, with potentially lasting effects. Economic disruption could affect capital flows, tourism, and even population growth since expatriates still account for a large portion of the UAE's population.

Saudi real estate remains fueled by domestic considerations, including homeownership targets and reforms. Residential prices and rents continue to soar in the kingdom. The cities of Riyadh and Jeddah saw year-on-year sales prices jump by 10% and 5%, respectively, in the first half of 2024. Economic indicators and population growth will remain strong in 2025 given the significant government investment in Vision 2030 (see below), new household formations, and strong outlook for non-oil growth. We expect demand for residential real estate will remain high, particularly in Riyadh and Jeddah due to domestic migration.

Vision 2030 targets a 70% homeownership rate in Saudi Arabia by 2030, and the kingdom is on track to achieving this, with the rate hitting 63.7% at the end of 2023, driven by various initiatives by the government. While foreign direct investments (FDI) remain low in the sector, visa policy reforms and regulatory changes could accelerate growth. For example, the government has introduced five new products to the Premium Residency program to stimulate demand from foreign buyers.

The present conflict in the Middle East has not had much impact on Saudi Arabia, with debt yields remaining broadly stable and tourism inflows robust. However, if tensions were to escalate, we could see a higher risk premium on debt; weaker tourism, FDI, and capital inflows; and more pressure on defense spending. This, in turn, could prevent Saudi Arabia from achieving some of its Vision 2030 targets.

Israel

The housing market is showing signs of recovery, even with the ongoing war and high interest rates. Transaction volumes are on the rise, with the number of apartments sold in the first three quarters of 2024 increasing by approximately 34% compared to the same period in 2023. This growth was even more significant in the new apartment market, with approximately 47% rise in sales. The heightened demand has led to an increase in the home price index, reflecting a moderate real increase when accounting for inflation. We believe this sales growth is partly due to buyers adapting to the war but mainly driven by developers' intensified marketing efforts. These efforts included favorable payment conditions (such as only 20% advance payment with the remainder upon delivery, attractive mortgage options), exemption from linkage to the construction cost index, and improved apartment specifications. We think developers are pushing these sales efforts to mitigate the burden of rising financing and construction costs. However, this strategy increases the funding requirements for homebuilders and puts pressure on profitability.

The inventory of unsold new homes has reached a historic high. Due to the war, the construction industry suffered a workforce shortage along with disruptions in the supply of raw materials, which in turn caused cost overruns and delays in construction. Building starts and completions were weakened in the first half of 2024 and, compared to the same period in 2023, were lower by about 7% and 13%, accordingly. Even with the increase in sales and the drop in building starts, the number of unsold new homes reached about 70,000 in September, one of the highest levels historically.

The pace of sales will continue to rise, with prices increasing at a moderate rate. Israeli demographics, which support steady demand growth, along with expectations of economic recovery in 2025 and a low unemployment rate, should lead to an increase in transaction rates towards the second half of 2025. This, in turn, should result in a higher rate of increase in the housing price index. However, in the short term, high construction costs, workforce shortages, high interest rates, and the sales efforts are putting negative pressure on the credit quality of weaker and more leveraged companies.

Industry Outlook: Asia-Pacific

Ratings trends and outlook

We expect Chinese developers to face shrinking liquidity buffers and rising leverage as sales and margins continue to decline. That said, we believe China's property sales could stabilize toward the second half of 2025, depending on the government's continued support of favorable funding conditions.

In Hong Kong, we expect rated developers to be cautious in land spending to control debt and leverage. Developers may sacrifice margins to destock in the next year or two.

In Indonesia, we expect developers' refinancing risks will be reduced significantly in 2025 due to liability management exercises performed in 2024.

Main assumptions about 2025 and beyond

1. China's primary property sales will decline.

National average primary home prices will decline in 2025, primarily due to increasing inventory levels and market dynamics, and developers may resort to price-cutting. In higher-tier cities, prices may stabilize gradually.

2. Hong Kong's primary residential supply will outstrip demand.

Primary residential sales volume will rise in 2025, and developers could adopt conservative pricing strategies to clear inventories, which could hinder a rebound in Hong Kong's home prices.

3. Indonesia's property sales could contract without further stimulus.

The scheduled expiration of value-added tax (VAT) reduction at the end of 2024 will dampen housing demand in 2025.

China's average primary home prices will decline by 4%-6% in 2025, primarily due to increasing inventory levels and market-driven pricing. National unsold completed homes stood at 732 million square meters (sqm) as of September 2024, compared with about 500 million sqm during 2018-2021. As inventories continue to rise, developers may resort to price-cutting to destock. The price cut will be more severe in lower-tier cities. In 2025, we expect primary housing prices in China's tier-one cities to fall by 3%-5%, tier-two cities to fall by 5%-7%, and lower tier cities to fall by 7%-9%. In higher-tier cities that have less supply and stronger demand, home prices could stabilize first and developers will face less destocking pressure. As of the end of July 2024, primary home inventories (including completed and uncompleted units) in 100 cities was 26.6 months, of which inventory at tier-one cities was 20 months, tier-two cities was 23 months, and lower-tier cities was 34 months.

Primary residential supply in Hong Kong will outstrip demand. As of September 2024, completed but unsold inventories stood at 21,000 units, which exceeds our demand forecast for 2025 and the annual demand for most of the past five years, the peak of which was only 21,108 units in 2019. Furthermore, some 77,000 units of new supply are under construction and set for completion over the next three to four years. We expect sales volume of primary residences to rise to 20,000 units in 2025 from an estimated 18,000 units in 2024, on the back of easing mortgage rates and market-boosting measures by the government. We expect developers will adopt conservative pricing strategies to clear inventories, which will hinder a rebound in Hong Kong's home prices.

Indonesia developers' free operating cash flow will remain thin. Indonesia's property sales could contract by 5%-10% in 2025 without further stimulus. The scheduled expiration of VAT reduction at the end of 2024 will dampen demand in 2025, which in turn will dampen operating cash inflow in 2025. In addition, as more developers refinanced their U.S. dollar offshore notes with domestic bank loans, annual amortization of these loans will consume the majority of the free operating cash flow. That said, easing inflation and moderating mortgage rates will partially mitigate the contraction.

Credit metrics and financial policy

In China, we expect developers' revenue and margins to decline due to both lower sales volume and average selling price. Consequently, their average debt-to-EBITDA ratio is likely to increase from 6.3x in 2023 to 7x in 2024. We also expect developers' liquidity buffer to shrink and that they will need to ensure their access to financing channels. For the time being, developers that have better financing pathways are those who have state backing or have sufficient investment property assets that could be pledged to obtain bank borrowing.

In Hong Kong, we believe developers' margin squeeze is not over. We anticipate further pressure over 2025-2026 as developers book lower-margin residential projects. By our estimate, rated developers' weighted average adjusted EBITDA margin will edge down to 34.9% in fiscal 2026 from 36.5% in fiscal 2024, which could pressure leverage levels. But we expect developers will have the flexibility to cut land spending to control leverage because most of them have a sufficient land bank in Hong Kong for development for the next five years.

Indonesian developers have divergent credit metrics. For developers with weaker credit quality, we expect revenue to soften in 2025 due to lower sales if there are no further stimulus policies in 2025. This will reverse a temporary boost in credit ratios in 2024 following several below-par tender offers. In contrast, developers in the 'BB' rating category should maintain stable credit metrics in 2025, as growing recurring income from the investment portfolio will offset a potential decline in property development revenue. Developers with higher recurring income have more flexibility to engage in selective expansionary capital spending or opportunistic acquisitions.

Key risks or opportunities around the baseline

1. Property demand in China could weaken if the U.S. hikes tariffs significantly.

Significant hikes in U.S. trade tariffs on Chinese goods could make developers less inclined to invest, and prompt prospective homebuyers to delay making purchases. This would hamper the stabilization of the property market.

2. The decline in Hong Kong's mortgage rates could slow if U.S. inflation rise.

We expect investment-driven homebuying demand to increase as the gap between mortgage rates and residential rental yields narrows.

3. Proposed property taxes cut in Indonesia may support demand.

Indonesia's president-elect proposes to suspend property taxes, including the 11% VAT and 5% land and building acquisition tax, for the next one to three years.

China property demand could slow further if the U.S. hikes trade tariffs significantly. The stabilization of China's property market relies on the restoration of confidence of developers and homebuyers. If China's economy softened due to significant hikes in U.S.'s trade tariffs on Chinese goods, we believe developers would be even less inclined to invest. Prospective homebuyers that sense developers lack confidence in the market may further delay their purchasing decisions. As a result, China property sales could fall below our base case and it would take a much longer time for China's property market to stabilize.

China could roll out more property stimulating measures should property demand wane further. For example, in mid-November, the Ministry of Housing and Urban-Rural Development announced that the government will target 300 cities for the redevelopment of urban villages and dilapidated housing, instead of the originally announced 35 cities. Furthermore, the government also reduced property-related taxes in mid-November to stimulate demand. In our view, these demand-side policies, if implemented effectively, could help absorb existing inventories.

The decline in Hong Kong's mortgage rates could slow if U.S. inflation rise. We expect investment-driven homebuying demand to increase as the gap between mortgage rates and residential rental yields narrows. Mortgage rates have further room to drop in Hong Kong if the U.S. Federal funds rate continues to fall. However, if inflation expectations in the U.S. rise, the Fed funds rate could be higher than our current forecast.

Mortgage rates in Hong Kong have generally dropped to 3.625% in November from over 4% before the U.S. Federal Reserve's cumulative 75 basis point cut since September. However, as home prices drop and residential rents rise—the latter rose more than 5% in the year to September—rental yields rise. As of September 2024, we estimate the gross rental yield for midsized mass-market properties (40-100 square meters) was about 3.3%. For properties under 40 square meters, their gross rental yield of 4.6% already surpassed the mortgage rates.

Proposed property taxes cut in Indonesia may support demand. Indonesia's president-elect proposes to suspend property taxes, including the 11% VAT and 5% land and building acquisition tax, for the next one to three years. The proposal is pending approval from the Ministry of Finance. If approved, it will boost property sales.

Industry Outlook: Latin America

Ratings trends and outlook

Homebuilders and developers will continue to recover gradually. Although more than 80% of our rated portfolio has a stable outlook, given the cyclicality of the homebuilding industry and economic and political volatility in Latin America (LatAm), we continue to be uncertain about the long-term outlook for the sector.

In Brazil, profit margins have weakened. Work stoppages during the pandemic and supply-chain disruptions coupled with the persistently high interest rates lifted construction costs and delayed project completions, resulting in a drop in homebuilder and developer profitability during 2022-2024. We now expect their profitability to rebound in the next few years at a slower pace than we previously forecasted, given the higher inflation and still-high interest rates in Brazil. Although most of the rated companies in the sector have some cushion on their balance sheets, margin recovery and cash generation trajectory amid a high-interest rate environment will permeate potential future rating actions.

In Mexico, housing demand to surpass the tight supply of units. This should allow homebuilders to keep passing inflation costs to homebuyers and protect their profit margins. Moreover, we expect financial institutions to remain well capitalized, with mortgage financing availability and a modest improvement in financing conditions as the central bank continues cutting the reference interest rate. President Claudia Sheinbaum's strategy of building 1 million new homes over her six-year term could represent an opportunity for Mexican housing starts to rebound, but will likely be accompanied by challenges. Overall, we expect rated homebuilders to maintain their healthy balance sheets, supported by conservative financial policies toward the use of debt, prudent liquidity management, and their flexible business models.

Main assumptions about 2025 and beyond

1. Brazilian homebuilders' launches and sales to continue benefit from changes in the housing program.

We expect mid- to high-tier developers to start constructing low-tier homes due to changes in the Minha Casa Minha Vida (MCMV) program that took place in 2023 and 2024, which expanded subsidies, enhancing access for buyers and profitability for developers.

2. They're also poised to manage debt and reduce leverage.

About 40%-60% of rated Brazilian homebuilders' debt consists of debentures and corporate instruments, with 25% maturing in 2025. Increased cash generation from project deliveries and the MCMV program will enable them to reduce leverage.

3. Mexico’s rated homebuilders would maintain healthy revenue growth, profitability, and leverage.

We expect homebuilders to continue benefiting from the housing deficit in the country, allowing them to pass on most inflation costs to homebuyers.

MCMV program changes to increase housing launches in Brazil. Housing launches and net sales jumped in 2023 and 2024. Despite the slowdown in savings account-based home financing, which potentially weakens builders' pricing power, the drop in inflation accelerated the sales pace. This has expanded the pool of potential homebuyers.

In addition, we expect mid- to high-tier developers to engage in construction of low-tier houses. This shift is largely due to modifications to the MCMV program. For instance, in July 2023, the federal government raised the price ceiling for homes sold under the program's Bracket 3 from R$264,000 to R$350,000 and expanded housing subsidies. We believe these changes will increase access to the MCMV program for potential homebuyers. Simultaneously, these changes are likely to raise the profitability of low-tier homes sold through the program.

Therefore, we expect housing launches to rise to high-single digits in 2025. However, high basic interest rates, squeezing available credit for homebuying, could pose risks for mid-tier projects. This is particularly the case during the transfer phase, where the increase in initial mortgage payments may not align with buyers' gross monthly incomes, potentially leading to increased sales cancellations and delays in cash-flow recovery.

In Brazil, operating improvements likely to help reduce leverage. Approximately 40%-60% of the reported debt among the Brazilian rated homebuilders consist of debentures and other corporate debt instruments. The remaining portion is related to construction credit lines, which are also linked to unit transfers to banks through real estate credits.

Out of the total debt outstanding among these entities, around 25% will mature in 2025. Considering the expected cash generation starting in 2025 stemming from the higher number of project deliveries, and cash-flow benefits from launches under the MCMV program, we believe Brazilian builders will use cash to reduce leverage.

However, a significant portion of their debt will likely need refinancing, prompting homebuilders to tap capital markets and seek financing from banks. We don't view this as a major credit risk as we believe the depth of the Brazilian capital and banking markets would be sufficient to cover those needs for entities with solid credit fundamentals. In addition, due to likely growth in housing launches, we believe homebuilders will seek financing to execute projects and acquire land.

Mexican homebuilders should keep a steady operating and financial performance in 2025. We expect revenue to grow near 4%-8% in 2025 on the back of low-single-digit percent unit growth and average price increases. We expect homebuilders to continue to benefit from an easing on inflation in key input costs, which should help to keep healthy profit margins. Moreover, we assume rated homebuilders will continue to pass on most inflation costs to homebuyers through average price increases, particularly in medium and residential segments that tend to be more inelastic to price changes, and because of their proven ability to adapt to market needs. We expect rated homebuilders will remain prudent in terms of new developments and debt, which should keep their leverage broadly stable in the next 12 months.

Housing starts in Mexico remain at low levels, with about 129,700 units in the 12 months ended October 2024. In our view, this is due to tough business conditions over the last few years, the dwindling number of federal subsidies, and relatively high inflation, which weighs on homebuyers' investment decisions.

Still, the country faces a large housing deficit and the announced new housing strategy from the government of building 1 million new homes over its six-year term holds promise for homebuilders, notwithstanding that half of the potential homes would address a segment of the population that is not the core market of rated homebuilders. We continue to expect rated homebuilders to benefit from the housing deficit, slowly growing formal employment and stable mortgage rates. Moreover, government-owned entity, Instituto del Fondo Nacional de la Vivienda para los Trabajadores (Infovanit) and el Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (Fovissste) will continue looking to expand their housing programs and customer bases, in line with the national housing plan. We also expect house price appreciation to moderate, in line with easing inflation.

In our view, these factors support the expected 2025 growth trajectory of the following Mexican rated homebuilders: Consorcio ARA S.A.B. de C.V. (national scale: mxAA-/Stable/--); Inmobiliaria Ruba S.A. de C.V. (national scale: mxAA-/Stable/mxA-1+); and Vinte Viviendas Integrales S.A.B. de C.V. (global scale: BB-/Positive/--; national scale: mxA-/ Positive /--). We expect rated Mexican homebuilders to continue leveraging their competitive positions and business flexibility from strong inventories, landbank reserves, and geographic, product, and financing diversification to keep a steady operating and financial performance.

Credit metrics and financial policy

Metrics will gradually improve for Brazilian homebuilders in 2025. Following the 2015-2017 Brazilian economic crisis, the overall housing sector adopted a more-conservative approach in terms of financial policy, with most of rated issuers maintaining extended debt maturity profiles. For most of the companies we rate, this helped them get through 2022 and 2024 without significant negative rating impacts, excluding some specific cases. Nonetheless, persistent high interest rates, with our expectation of an average basic interest rate of 10.9% in 2025, are still weighing on companies' interest burden and coverage ratios. In this scenario, we have been seeing some rated issuers focusing on liability management, whether through refinancing or by reducing gross debt. Additionally, we expect Brazilian homebuilders to continue to rely heavily on construction financing debt or even structured product issuances, as these lines usually have better cost and terms. Given the above, we forecast credit metrics to improve from 2025 for Brazilian homebuilders, with an FFO-linked ratios presenting an upward trajectory in the next quarters.

Mexican homebuilders to maintain prudent financial policies. We expect rated Mexican homebuilders will continue to prioritize strong balance sheets, relatively low leverage, sound liquidity, and making investment decisions subject to their financial position. Following two years of high investments in land and housing construction, working capital needs should moderate in 2025, which should result in slightly positive free operating cash flow and credit metrics consistent with the ratings. Moreover, we view refinancing needs as low for 2025, due to proactive liability management.

Further consolidation of the Mexican housing industry is unlikely in 2025. In May 2024, Vinte Viviendas Integrales S.A.B. de C.V. announced its intention to acquire up to 100% of Servicios Corporativos Javer S.A.B. de C.V.'s capital stock through a mix of equity and debt. We believe further consolidation in the industry is unlikely at this moment. Although they may bring economies of scale, some of the potential remaining targets operate within the same markets as potential buyers, making transactions less attractive in terms of geographic diversification. Moreover, a potential acquisition would likely result in higher use of debt, which would be a departure from the prudent financial policies established by rated entities like Consorcio ARA or Inmobiliaria Ruba.

Key risks or opportunities around the baseline

1. Macroeconomic downside risks.

Economic and political conditions in the LatAm region have proven relatively volatile in past years, raising questions regarding long-term prospects for the homebuilder industry in the region.

2. Solid medium- to long-term growth prospects.

The region maintains a significant housing deficit and benefits from a growing middle-class and well capitalized banks, which suggests growth opportunities for homebuilders in the medium to long term.

3. Brazilian regulatory changes benefit capital raising.

The new resolution has restricted the eligible collateral for issuing Real Estate Receivables Certificates (CRIs), with the aim of prioritizing funding for the real estate sector. This change has significantly narrowed the pool of potential issuers, which could enable developers to raise capital at more attractive rates.

4. High interest rates chip away at primary source of mortgage funding.

Since 2021, savings deposits have stagnated, while residential loans have seen significant growth. To diversify funding sources, banks are increasingly issuing letters of credit and securitizations, a trend we expect to continue.

Brazil's regulatory changes facilitate capital raising at more attractive rates. The introduction of Resolution CMN 5,118 on Feb. 1, 2024, restricted the eligible collateral for the issuance of Real Estate Receivables Certificates. The primary objective of this change is to prioritize the allocation of funds raised through CRIs to companies in the real state sector. As a result, the pool of potential issuers has significantly narrowed. In our view, this should reduce competition for financing, enabling developers to raise capital at more attractive rates.

Challenges from the MCMV program. Mid- to high-tier developers' participation in the MCMV program requires a certain level of expertise to ensure project profitability, such as navigating the bureaucracy involved in applying for the program. Moreover, given the lack of inflation adjustment after the transfer of newly built units to banks, the high speed of construction and the high cost of land and labor pose difficulties in maximizing the profitability of each project and reducing exposure to potential inflationary spikes.

High interest rates chip away at primary source of mortgage funding. In Brazil, banks are required to allocate 65% of special savings deposits (SBPE) for mortgage lending due to a lack of long-term funding options. Since 2021, savings deposits have stagnated while residential loans have grown significantly.

To diversify funding sources, banks have increased the issuance of LCIs and securitizations. We expect this trend to continue as high interest rates impact deposit growth. We anticipate that the share of mortgages in total loans will remain stable, with Caixa Econômica Federal (BB/Stable/B) holding a significant market share. However, restricted access to saving accounts-funded mortgages and high interest rates may pose risks to the financial health of the homebuilder sector.

Mexican economy to slow in 2025. Our base case assumes the Mexican economy will continue to slow down in 2025 with an expected GDP growth of 1.2%, reflecting higher uncertainty regarding its trade relationship with the U.S., which we believe will take a toll on investment. In addition, recently approved Mexican reforms—such as changes to the judicial system— could delay investment decisions until there is more clarity on the implications of those bills. In our view, a weaker-than-expected economy amid elevated house prices could result in weaker demand, which could undermine homebuilders' capacity to pass through cost increases or raise working capital, and ultimately undermine operating and financial performance if not addressed.

Solid medium-to long-term growth prospects to Mexican housing industry. We believe the Mexican housing industry should benefit from structural factors such as a housing deficit of about 8 million, a gradual rise in formal employment, and mortgages availability from well-capitalized financial institutions. We also expect financial conditions to improve in the next 12 months as the central bank continues to cut the reference rate. Although we do not expect this to have a major effect on mortgage rates, it could improve households' disposable income. These factors should support long-term demand for the formal housing sector.

Additionally, President Scheinbaum's housing strategy considers that Mexico's largest mortgage lender, INFONAVIT, will deliver 500,000 homes, although how it would manage this remains to be seen. If INFONAVIT decides to subcontract part or the full construction process to the private sector, homebuilders could benefit.

Related Research

- French Developers Are Navigating The Storm As Spanish Sail Ahead, Oct. 29, 2024
- Real Estate Monitor: Rate Cuts Could Spur Sector Recovery, Sept. 11, 2024

Industry Forecasts: Homebuilders and Developers

Chart 7

Revenue growth (local currency)

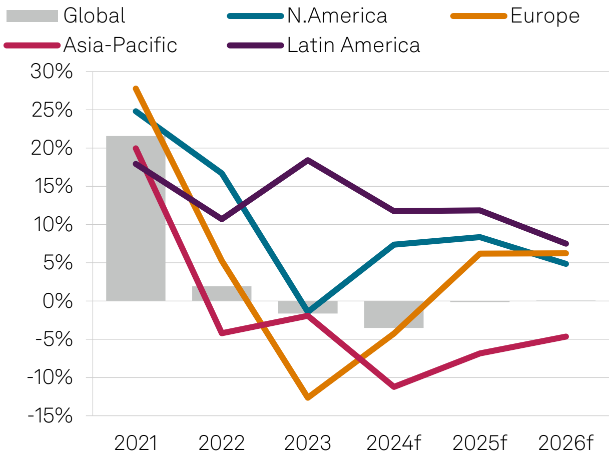


Chart 8

EBITDA margin (adjusted)

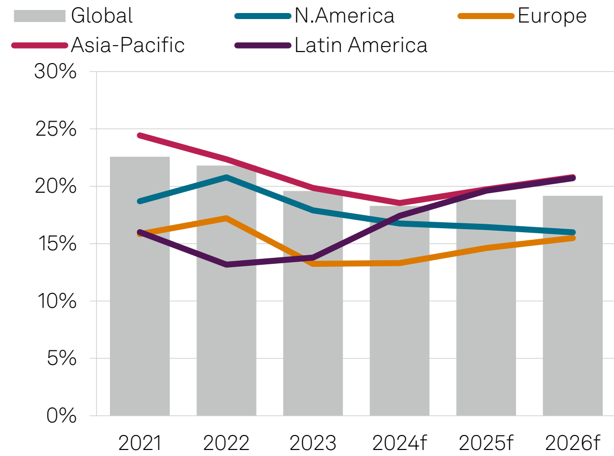


Chart 9

Debt / EBITDA (median, adjusted)

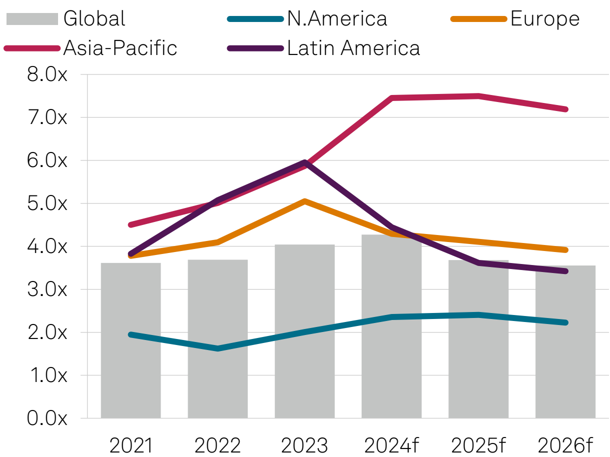
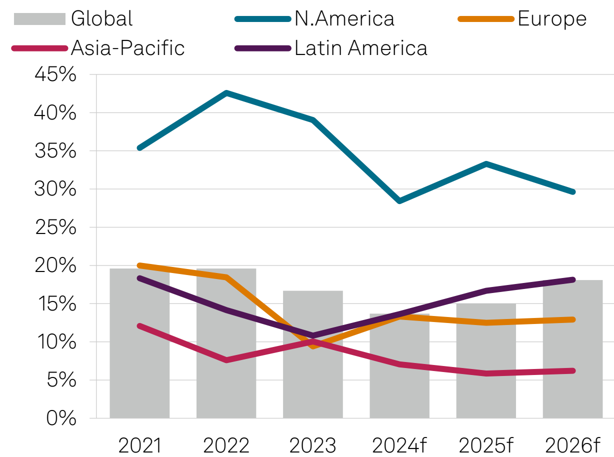


Chart 10

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are 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: Homebuilders and Developers

Chart 11

Cash flow and primary uses

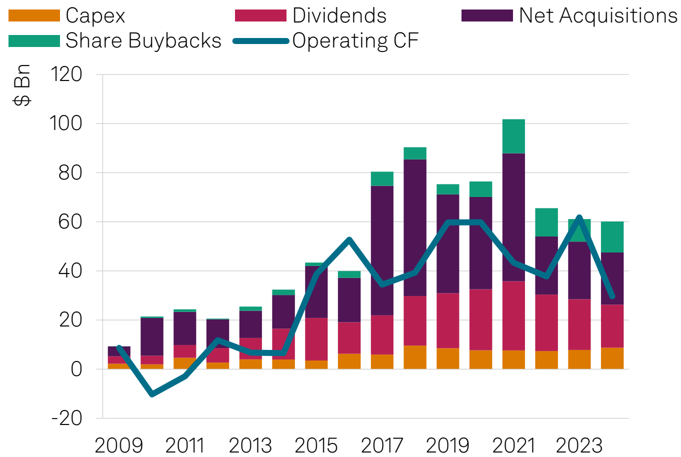


Chart 12

Return on capital employed

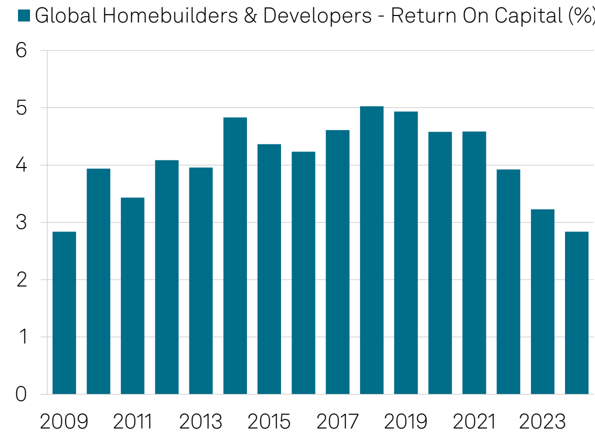


Chart 13

Fixed- versus variable-rate exposure

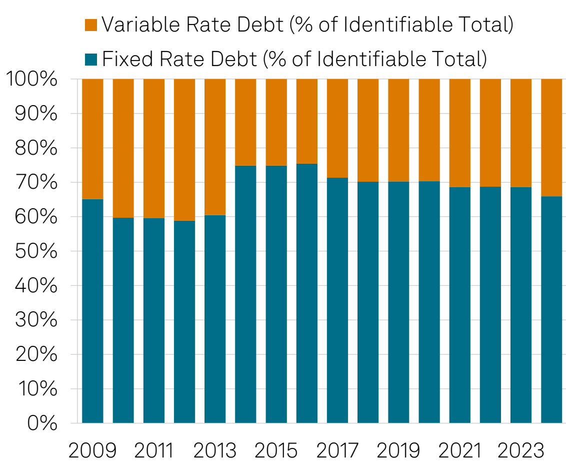


Chart 14

Long-term debt term structure

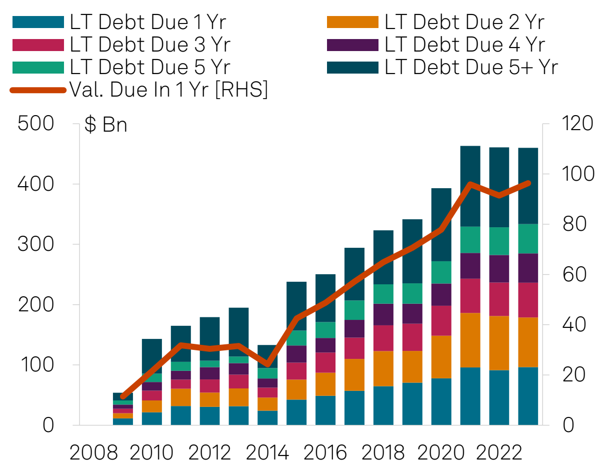


Chart 15

Cash and equivalents / Total assets

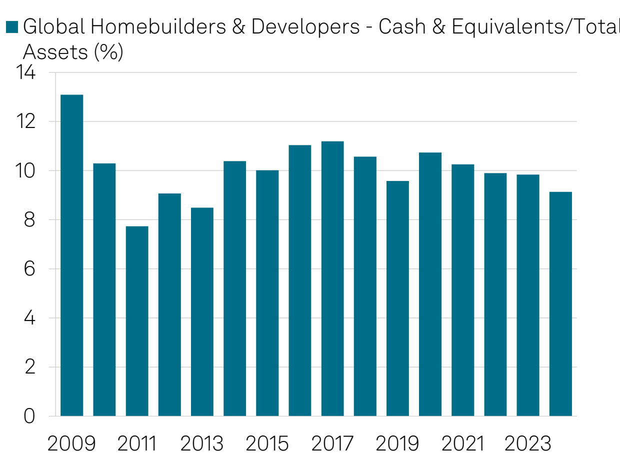
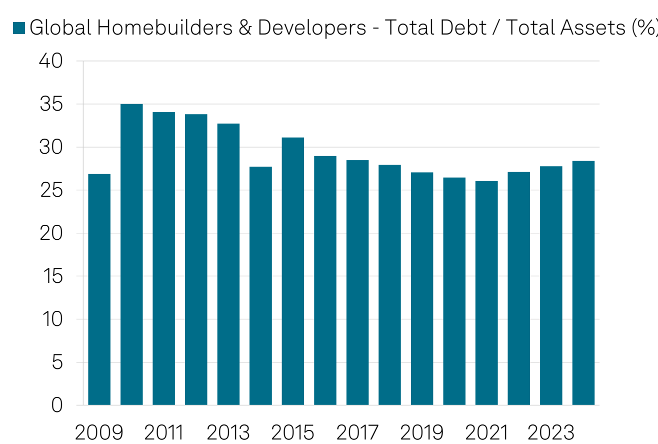


Chart 16

Total debt / Total assets



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