S&P Global Ratings

Real Estate (REITs)

Refinancing risks increase, asset corrections materialize

This report does not constitute a rating action

Franck Delage
Paris
franck.delage@
spglobal.com
+ 33 1 44 20 6778

What's changed?

The negative rating bias is higher. Of all the European real estate investment trusts (REITs) that we rate, 25% carry either a negative outlook or are on CreditWatch negative, up from 18% in January 2023. We have downgraded 12 companies over the past year.

Refinancing risks have increased as banks tighten their conditions and large debt maturities fall due. Real estate investors are finding it more difficult to attain new bank funding, especially those with limited bank relationships, tight covenant headroom, or few unencumbered assets.

Valuations by external appraisers are adjusting, albeit slowly. We continue to assume an average asset correction of 10% for rated European REITs, peak-to-trough, ranging from 5% to 24%. Companies reported only a third (3.4%) during the second half of 2022.

What to look out for?

Early refinancing, cash preservation, and covenant headroom are key concerns. Most companies have adequate liquidity, enabling them to cover debt maturities well beyond 12 months, but eroded cash buffers or covenant headroom could lead us to downgrade more issuers.

Debt-to-debt plus equity and interest coverage ratios should weaken. We estimate asset corrections and the higher cost of debt could result in debt-to-debt plus equity growing by three percentage points and interest coverage ratios falling by 0.5x, on average, between 2022 and 2025. Conversely, debt to EBITDA should improve by 1x, on average, thanks to lower investments and steady revenue growth.

The office segment shows more vulnerabilities. The combination of slowing economic growth and changing office utilization patterns will likely weaken the demand for office assets, particularly non-prime, and depress valuations more than other asset classes.

Rental growth should remain robust across most property segments. Rents rise with inflation because most leases are indexed to the consumer price index, and most costs are passed through to them. Supply also becomes rarer as building costs increase, keeping vacancy low.

What are the key risks around the baseline?

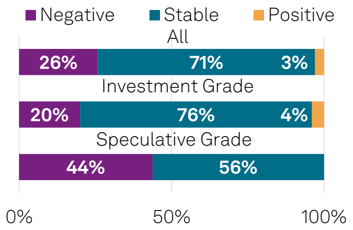
Distressed asset sales could exacerbate valuation pressures. Transaction activity remains subdued and difficult to materialize in the absence of clarity on terminal rates. However, refinancing struggles could force some asset sales at wide price discounts.

Economies contracting strongly and without a rate decrease. This would likely hamper tenant demand and hit valuations harder than expected, as the prospect of rental growth would no longer soften the rate impact on asset value declines.

Tighter regulation around properties' energy performance. This could require REITs to spend more on renovation when the cost of capital is high and access to funding rarefied.

Rating Trends

Outlook Distribution

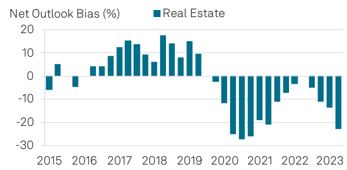


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	50	16	66
Downgrades	1	3	4
Upgrades	0	2	2

Ratings data as of end-Jun 2023. * Year-to-date. Current ratings only.

Ratings Outlook Net Bias



Related Research

European REITs: The Great Repricing Continues, Jul. 18, 2023

Spotlight On Refinancing Risks In European Commercial Real Estate, April 24, 2023

German Residential REITs Face A Mixed Outlook In 2023, Feb. 20, 2023