Real Estate

LOW INTEREST RATES, HIGH ASSET VALUES, AND STABLE TO IMPROVING FUNDAMENTALS SUPPORT A STABLE OUTLOOK

- **Ratings Outlook. REITs:** The REIT rating outlook is largely stable with a positive bias in North America reflecting steady economic growth, limited supply growth, improving employment and consumer spending that will drive rent growth and occupancy. Sluggish European economies will limit ratings upside there. Within APAC we believe business conditions will remaining satisfactory and financial trends should remain sound.

- **Homebuilders & developers:** Conditions are favorable for homebuilders in the U.S., U.K., France, China, and Mexico. Conditions are not as bright in countries such as Brazil, Russia, Indonesia, and Hong Kong due to weaker economic conditions or higher funding costs.

- **Forecasts. REITs:** We expect leverage ratios will remain largely unchanged as issuers are still cautious about undertaking sizable hostile debt-funded acquisitions. In addition, tighter capitalization rates are inflating asset values and keeping leverage in check.

- **Homebuilders & developers:** U.S. homebuilders should see home sales climb 10% in 2016, with average prices up in the low-single digits. APAC homebuilders could see diverging sector growth with China recovering to mild growth, Hong Kong turning down, and Indonesia staying flat.

- **Risks. REITs:** Potential risks include frothy asset valuations driven by market participants’ aggressive bidding and interest from private equity buyers and sovereign wealth funds.

- **Industry Trends. REITs:** Asset disposals will remain an important source of funding as REITs recycle capital and take advantage of strong asset values and interested financial buyers. Demographic shifts in millennial and baby boomer generations will influence rent versus buy decisions in the U.S. multifamily sector. E-commerce growth could drive growth in the industrial sector and poses a longer term risk for the retail sector.
Global Real Estate Ratings Distribution and Outlook

Chart 1 | Ratings Distribution

Rating distribution reflects a concentration of investment-grade issuers in the REIT sector and concentration of speculative-grade in the homebuilders/developers sector.

Chart 2 | Ratings Distribution by Region

APAC ratings are concentrated in the investment grade spectrum mainly driven by investment-grade REITs whereas North America is more balanced with a mix of investment grade REITs and speculative grade homebuilders/developers.

Chart 3 | Ratings Outlooks

Overall, our rating outlook is stable for the real estate sector with a slight negative bias because of the preponderance of negative outlooks in Latin America.

Chart 4 | Ratings Outlook by Region

There is a positive bias in North America with 17% of ratings in the region having positive outlooks. Outlooks in other regions are mostly stable with the exception of Latin America.

Chart 5 | Ratings Outlook Net Bias

The positive sector bias reversed to negative bias in 2015 because of the increased number of negative outlooks in Latin America.

Chart 6 | Ratings Net Outlook Bias by Region

Negative outlooks in Latin America accelerated in 2015 because of weak economic prospects in the region, while other regions maintain somewhat of a neutral rating outlook net bias.

Source: S&P Ratings
REITS
The positive trend in the U.S. reflects the continued steady economic growth, limited supply growth, and improving employment and consumer spending that will drive rent growth and occupancy. Sluggish European economies will limit rating upside, although low interest rates and improved financial risk profiles have driven a number of upgrades to date. We think business conditions in APAC will remain satisfactory and financial trends should remain sound for the next 12 months.

For Latin America, the higher proportion of negative outlooks is mainly linked to the negative outlooks on the sovereign ratings of Brazil and Argentina that limit the ratings on several companies at the level of the sovereign or at a specific number of notches above the sovereign rating.

Homebuilders/Developers
The ratings outlook for the U.S. homebuilding sector remains broadly stable, with support from our expectations for a continued favorable, but uneven national housing recovery. Several factors are limiting the rating upside for builders, including housing starts that still lag historical averages and the rising share of multifamily (versus single-family) starts. Given our generally favorable U.S. economic outlook, we see little ratings downside risk for the remainder of the year and going into 2016.

In Europe, growing revenues on the back of supportive regulatory measures being extended in several jurisdictions and healthy level of planned deliveries should sustain developers’ credit ratios in 2016.

Ratings in APAC have polarized, resulting in a more even distribution across the rating categories. We expect this trend to continue for the next 12 months.

The ratings trends for Latin America is mostly stable but with a negative bias due to weak macroeconomic conditions in Brazil that are pressuring demand and cash flow generation.
FORECASTS

REAL ESTATE INVESTMENT TRUSTS (REITS)

CHART 7 | DEBT / CAPITAL (ADJUSTED)

- Asia-Pacific
- N.America
- Latin America
- W.Europe
- Global

CHART 9 | EBITDA INTEREST COVERAGE (ADJUSTED)

- Asia-Pacific
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CHART 11 | DEBT / EBITDA (ADJUSTED)

- Asia-Pacific
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CHART 13 | FFO / DEBT (ADJUSTED)

- Asia-Pacific
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HOME BUILDERS AND DEVELOPERS

CHART 8 | DEBT / CAPITAL (ADJUSTED)

- Asia-Pacific
- N.America
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CHART 10 | EBITDA INTEREST COVERAGE (ADJUSTED)

- Asia-Pacific
- N.America
- Latin America
- W.Europe
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CHART 12 | DEBT / EBITDA (ADJUSTED)

- Asia-Pacific
- N.America
- Latin America
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CHART 14 | FFO / DEBT (ADJUSTED)

- Asia-Pacific
- N.America
- Latin America
- W.Europe
- Global

Source: S&P Ratings. All figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year end spot rate.
ASSUMPTIONS

### KEY INDUSTRY ASSUMPTIONS

#### NORTH AMERICA

<table>
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<th>Homebuilders/Developers</th>
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<tr>
<td><strong>We expect net operating income (NOI) trends to remain solid, increasing in the low- to mid-single digits while vacancy rates are likely to remain stable or decline slightly in some sectors.</strong> Development activity has increased in the multifamily, industrial, and (to some extent) health care sectors.</td>
<td><strong>We assume U.S. single-family homebuilders will grow at a slower pace than our economists’ forecast for U.S. housing starts increase of 15% to 20% next year. We estimate the weighted average price of a new home will be about $385,000 in 2015. We assume a similar increase for 2016.</strong></td>
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#### 1. Solid Outlook for US REITS.

For **North American REITs**, we expect net operating income (NOI) trends to remain solid, increasing in the low- to mid-single digits, with the multifamily and industrial sectors to outperform the office and mall sectors.

We expect **vacancy rates** to remain stable or decline slightly for some sectors, particularly those that have underperformed during this recovery. Other sectors are approaching or have achieved peak occupancy levels, and we think occupancy levels will remain relatively stable in 2016.

**Development** activity has increased in the multifamily, industrial, and (to some extent) health care sectors, though absorption rates have been good given growing demand. REITs have also managed risks by balancing build-to-suit with speculative development.

There is limited new development in retail since retailers are reducing square footage growth in favor of e-commerce growth, but property redevelopment is contributing to robust same-store growth.

Office **occupancy** levels have improved with high barrier-to-entry, coastal markets achieving better-than-average gains, while suburban markets continue to face challenges.

Less ability to issue equity because of shares trading at a discount to net asset value (NAV) could curtail acquisition or development activity. It also could create the need for REITs to recycle capital (through asset sales) as a funding source. Alternatively, companies could increase leverage to pursue growth, but for now we don’t think this is the preferred strategy given targeted rating levels.

#### 2. US Homebuilding Growing But Pace Varying Across States

We assume U.S. single-family **homebuilders** will grow at a slower pace than our economists’ forecast for U.S. housing starts increase of 15% to 20% next year (about 1.3 billion units), in part because multifamily units will continue to comprise a larger share of starts relative to the historical average. We expect most rated builders to sell between 5% and 10% more homes next year. Those operating in expanding southeast and west coast markets will grow faster, while those operating in mature markets in the northeast and midwest or markets where falling commodities prices have adversely affected the economy, such as Houston, will grow more slowly.

We estimate the weighted **average price** of a new home that rated U.S. homebuilders sell will be about $385,000 in 2015. That is only about 3% higher than 2014. We assume a similar increase for 2016. We believe home price appreciation will be constrained by a couple of factors: potential interest rate hike and lower land cost as builders buy cheaper land in secondary locations to improve affordability for their
customers; or because it is becoming more difficult or prohibitively expensive to acquire lots in more desirable markets.

The average gross margin for rated U.S. homebuilders dropped about 100 basis points (bps) based on our estimates for 2015. While higher land costs played a role, anecdotal reports from several builders indicate that labor shortages in certain markets were also a contributing factor. We expect these conditions to continue into 2016 and for the average gross margin to remain near the 2015 level at about 23%. Builders that still have land with carrying values that were written down during the housing crash or those that create value through the land entitlement and development processes will have higher margins. Those that buy finished lots on a just-in-time basis will have lower margins but less risk, in our view.

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**EMEA**

1. **Low Inflation Handicaps REITS in Europe**

   In Europe, we generally forecast low-single-digit revenue growth for REITS, thanks to widespread indexation of rents on varied measures of inflation. We observe three main trends that should support operating performance in 2016: U.K. real estate companies benefitting from strong market conditions; continental office lessors battling a tougher market but benefiting from low rates and better financial ratios; and German residential property players flourishing amid strong industry trends and favorable funding conditions.

   Our base-case scenario for REITS in Europe foresees stable or moderately improving interest coverage ratios in 2016.

   Robust economic conditions in the U.K., including GDP growth above the Eurozone average, a low unemployment rate, and good consumer confidence should continue to support strong revenue growth of U.K. real estate investment owners in 2016. Overseas demand for prime office assets in Central London is still very strong with aggressive bids pushing prices up. This combined with currently limited office supply has pushed occupancy rate to record low levels in Central London.

   In Germany, although commercial property companies do not experience as strong demand as the residential sector, we expect low-single-digit like-for-like rental growth for office and other commercial real estate players, bolstered by positive indexation.

   In France, in 2016, commercial real estate should deliver on revenue growth but offers low potential for valuation gains.

   We expect real estate markets in Southern Europe—Italy and Spain—to recover progressively over 2016-2017, which should support rents increases.

2. **Improving Housing Market Supporting Developers and Homebuilders**

   For developers, we are observing robust housing markets in the U.K. and Germany and recovering market conditions in the rest of continental Europe. For homebuilders, structural undersupply of housing in the U.K. continues to support demand for new homes and our forecast is for 5% growth in 2016 and 2.5% in 2017.

   For homebuilders, structural undersupply of housing in the U.K. continues to support demand for new homes, as well as government schemes such as help-to-buy and the low interest environment. We forecast 5% growth in 2016 (after 7% in 2015) and 2.5% in 2017.
**French developers** should see growing demand as fiscal uncertainty gradually evaporates and the underlying economy improves. Project starts and transaction growth turned positive in 2015 and we expect those trends to support French homebuilders and developers’ revenues at least throughout calendar 2016.

**Russian developers** are facing increased funding costs from significant increase in key refinancing rates and decreased availability of mortgage loans for apartment flat buyers. In March 2015, the Russian government introduced new schemes to subsidize mortgage lending that we expect to continue in 2016. For most developers, key refinancing rate has declined from its peak of 17% in early 2015 to 11% at year-end 2015, The cost of debt funding for Russian homebuilders is still expected to remain relatively high, pressuring companies’ earnings and limiting their ability to launch new development projects.

**ASIA PACIFIC**

### 1 | REITS

Median interest coverage is likely to improve over the medium term because of the low, average, base interest rate, even though we factor in a modest increase in interest rates into our base-case. REITs will maintain a cautious approach to debt usage as the sector remains hesitant to make debt-funded acquisitions.

### 2 | Homebuilders/Developers

We estimate developers in China will generally meet their annual sales targets in 2015. We also predict the government will continue to release more supportive measures to counter the deceleration in real estate investment. As a consequence, we believe sales will grow 0% to 5% in 2016. In Hong Kong, prices have moderated ahead of the expected U.S. interest rate raise and increasing supply outlook and we expect a gradual decline in sales in 2016.

#### 1. Low Interest Rates Support REITS But Debt Demand To Remain Muted

The median interest coverage for the rated sector is likely to improve over the medium term because of the low, average, base interest rate, even though we factor in a modest increase in interest rates into our base-case assumptions.

Forecast debt usage will likely remain relatively static as the sector remains hesitant to make debt-funded acquisitions when competing with capital-rich funds.

REITs will maintain a cautious approach to debt usage, as reflected in their liquidity positions. Many REITs will draw on debt at the lower end of their financial policies.

Real estate investment markets where the REITs are located (Australia, China, Hong Kong, Japan, Singapore, and Taiwan) have varying supply conditions that will modify the prospect of demand and rents in each market.

#### 2. China Property Prices Picking Up Responding To Government Measures

China’s property market conditions have continued to improve over the course of the year. Average selling prices (ASP) in many cities have reversed back into positive month-on-month growth. Overall contracted sales for residential housing have also demonstrated a healthy increase, led by higher tier cities, given the inward migration, better economic prospects, and stronger demands. We estimate developers will generally meet their annual sales targets in 2015. We also predict the government will continue to release more supportive measures to counter the deceleration in real estate investment, providing additional fuel to the sector. In 2016, we believe sales will grow 0% to 5%, mainly driven by higher ASP while gross floor area (GFA) sold may stay flat or slightly decreases from the 2015 level.

In Hong Kong, prices have moderated ahead of the expected U.S. interest rate raise and increasing supply outlook. We expect this to lead to stiffer competition among developers, which are likely to adopt a more flexible pricing strategy and focus on asset turnover. Primary sell-through ratios are slowing and secondary volumes are at a low, signaling a correction is likely to come. The property market remains sensitive to local economic conditions particularly related to the decelerating tourism sector and China’s...
growth slowdown spilling over. We expect the correction to be gradual, up to 10% down in 2016 compared with 2015 sales, mainly driven by falling ASP.

Sales for Indonesian developers have plunged since June 2015 with many companies hitting less than half of their budgeted sales for 2015. The sector had been fairly resilient to reduced domestic GDP growth prospects and weaker consumer sentiment across other sectors until mid-year. The timing of interest rate hikes, currency volatility, and any lasting effects of the government taxpayer crackdowns could keep buyers cautious for at least the next six months. We are now assuming mostly flat property sales across the sector in 2016.

LATIN AMERICA

1 | REITS Holding back On New Projects

We expect occupancy rates to remain stable or face only small declines for the premium REITs we rate, thanks to their portfolio attractiveness and focus on the higher-income segment of the population, which is less affected by weaker macroeconomic conditions. We forecast revenue growth mainly because rental contracts are indexed to inflation rates.

Lower capex levels for 2016 compared with previous years, because of the uncertain macroeconomic scenario, with companies pursuing small area expansions and no relevant new projects. We also forecast a prudent approach to debt as a result of lower financing needs and the current high interest rates.

2 | Homebuilders/Developers – Brazil Weak, Mexico Better

Continued weak demand and sales cancelations should maintain inventories at high levels in Brazil, despite much lower launches. Additionally, we would expect higher sales expenses and discounts to pressure margins.

On the contrary, we expect Mexican homebuilders to take advantage of improving demand to post steady revenue growth and stable profitability. We expect Mexican homebuilders to maintain adequate access to debt markets, while there would be some limitation for Brazilian issuers.
Risks and Opportunities

Key Industry Risks and Opportunities

North America

1 | REITs

Interest rate normalization is a risk for the REIT sector in terms of funding cost and access to capital markets in 2016. However, we expect most REITs can absorb a modest increase in interest rate costs without having a significant impact on their financial risk profiles given the improving operating performance and limited refinancing needs in 2016.

Opportunities:

- REITs continue to focus on improving portfolio quality by pruning lower quality assets through spin offs or merger and acquisition (M&A) transactions to gain scale and enhance competitive positions.
- Despite some recent volatility in the equity markets, capitalization rates remain low and pricing and valuation indicators remain relatively high for some sectors. These could be catalysts for REITs that are not publicly traded to pursue IPOs or for rated issuers to consider further spin offs or M&A activity in 2016.
- We expect dispositions to remain an important source of funding for rated REITs as companies recycle capital and take advantage of strong asset values and interested financial buyers.

2 | Homebuilders/Developers Opportunity

Homeownership remains near 30-year lows at less than 64%, in large part because many millennials rent or to stay at home. This generation is now closer to the age where they may decide to buy a home. This is an opportunity for homebuilders, particularly those that offer homes in urban areas or with amenities.

Opportunities:

- Homebuilding is capital intensive during expansionary periods. Builders typically acquire land a year or longer in advance of constructing a home. Those with access to capital markets at reasonable costs have an opportunity to grow more quickly relative to smaller, capital constrained competitors because they can afford to bid a bit more for well-located lots or buy larger parcels. They also have the opportunity diversify their product offerings or geographic footprints by acquiring smaller competitors that are well positioned in their market but possibly hampered by a weak balance sheet.


- Risks: Interest rate normalization is a risk for the REIT sector in terms of funding cost and access to capital markets in 2016. However, we expect most REITs can absorb a modest increase in interest rate costs without having a significant impact on their financial risk profiles given the improving operating performance and limited refinancing needs in 2016.

- We think rated REITs can manage a growing development pipeline in some sectors. Development activity has increased in the multifamily, industrial, and (to some extent) health care sectors, though absorption rates have been good given growing demand. REITs have also managed risks by balancing build-to-suit with speculative development.

- Opportunities: REITs continue to focus on improving portfolio quality by pruning lower quality assets through spin offs or merger and acquisition (M&A) transactions to gain scale and enhance competitive positions.

- Despite some recent volatility in the equity markets, capitalization rates remain low and pricing and valuation indicators remain relatively high for some sectors. These could be catalysts for REITs that are not publicly traded to pursue IPOs or for rated issuers to consider further spin offs or M&A activity in 2016.

- We expect dispositions to remain an important source of funding for rated REITs as companies recycle capital and take advantage of strong asset values and interested financial buyers.

2. Millennials To Underpin Homebuilding, Emerging Markets Are The Main Concern

- Risks: Our economists’ downside scenario assumes conditions in China and other emerging markets drag down the U.S. economy in 2016. In a scenario where China’s GDP expansion was 2% below baseline forecast, U.S. GDP growth would be just above 1% and unemployment would remain above 5%. We would expect interest rates to remain low in this scenario and for housing starts to grow more slowly, at about 10% next year to 1.2 million units.

- Opportunities: Homebuilding is capital intensive during expansionary periods. Builders typically acquire land a year or longer in advance of constructing a home. Those with access to capital markets at reasonable costs have an opportunity to grow more quickly relative to smaller, capital constrained competitors because they can afford to bid a bit more for well-located lots or buy larger parcels. They also have the opportunity diversify their product offerings or geographic footprints by acquiring smaller competitors that are well positioned in their market but possibly hampered by a weak balance sheet.
Homeownership remains near 30-year lows at less than 64%, in large part because many millennials have chosen to rent or to stay home with their parents. This may be because they are saddled with student loan debt, because they are waiting longer to marry, or because they simply prefer a more flexible housing option. But the older cohort of this generation is now in their 30’s, presumably closer to the age where they finally decide to form households and buy a home. This is an opportunity for homebuilders, particularly those that offer homes in urban areas or with amenities this generation finds attractive.

**EMEA**

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Across Europe, recent increases in property valuations have been partly driven by low interest rates. A change in monetary policy and more expensive funding conditions would likely depress valuations unless rents adjust upward with only a limited time lag.

**Opportunities:**

- We believe the current low interest environment will prevail in the Eurozone in the near term, enabling companies to continue refinancing in favorable conditions. As a consequence, we expect interest coverage ratios to remain robust for most European REITs.

- Ahead of the “Brexit” vote before 2017, Britain’s EU membership will be debated over the next 12 months. In the short run, we expect limited impact on the U.K. rental market which remains supported by strong fundamentals. However, an exit from the EU would likely have more serious implications for the sector.

- M&A activity was high in Germany in 2015 and we expect the trend to continue in 2016. The growing numbers of immigrants, particularly the recent influx of refugees to Germany, is also likely to contribute to rising home prices and rents, supporting revenue growth and low vacancy rates for German REITs.

**2. Affordability And Availability Of Mortgages In U.K. Are Concerns**

**Risks:**

- Although, we view market conditions as favorable for homebuilders in the U.K., we believe deteriorating housing and/or mortgage affordability may affect demand and increase cancellation rates.

With the significant rise in property prices in the U.K. over the last couple of years, affordability of housing has been deteriorating. This is evidenced by the rise in the
house price-to-average earnings ratio from a low of 4.35x earnings in late 2012 to 5.2x as of August 2015.

Good conditions in the mortgage market including low interest rate environment and increasing competition between mortgage providers have, on the other hand, improved mortgage availability to homebuyers. A potential rise in interest rates the U.K. that we believe could occur in 2016 may challenge the housing market recovery.

Rated Russian developers have lengthened their debt maturity profile and accumulated cash reserves in recent years but they are still exposed to the limited availability of affordable medium and long-term funding. Any deviation from prudent refinancing, long dated debt maturities, and cautious liquidity management policy could jeopardize any Russian developer’s credit quality.

**Opportunities:** The U.K. government introduced in 2013 schemes to improve access to mortgage finance for homebuyers, in particular for first time buyers. Large U.K. homebuilders report that about a third of their sales are currently completed using government schemes. The U.K. government recently confirmed that it extended the help-to-buy scheme until 2020, which should continue to support future demand, in our view.

The U.K. government is also seeking to improve its planning system and to implement a public land release program. Planning permission has always been considered as one of the main factors constraining housing supply. An easing of planning permission would benefit U.K. homebuilders.

In France, demand for newly built houses and flats should be boosted by a new set of government incentives (“Loi Pinel” scheme; interest-free loans for first time buyers) and a planned increase in deliveries. This should support French property developers’ margins in 2016.

**ASIA PACIFIC**

**1 | REITS**

With the evolving regulatory regimes in Asia-Pacific, the opportunities for REITs to diversify out of their home markets, undertake increased development, and incur more debt are becoming viable.

**2 | Homebuilders/Developers**

We believe risk for the sector in China is decreasing because of recovering market sentiment and sales performance, and our expectation that Chinese government will continue to release supportive measures.

1. **REITS Looking To Scale Up In Asia**

**Risks:** Given the recent sales transactions, some sizable market participants are confident that future property income levels can be sustained, and are thus willing to pay a premium over book value. This ‘wall of money’ is making it difficult for the local rated incumbents to expand via acquisitions, forcing them to look at redeveloping their existing asset base instead. While the redevelopment economics are sound, the risk is that our rated managers will seek to deploy future capital to marginal asset enhancements or speculative greenfield investments that generate insufficient returns.

The risk premium attached to raising debt is increasing in the capital markets. Nevertheless, the debt markets remain open to the real estate sector and the rated sector maintains a sizable portion of undrawn bank debt.

**Opportunities:** With the evolving regulatory regimes in Asia-Pacific, the opportunities for REITs to diversify out of their home markets, undertake increased development, and incur more debt are becoming viable. While this trend has yet to gain meaningful traction, we are forecasting that the companies we rate will adopt a prudent approach that is consistent with their operating strategies.
2. **Hong Kong Starting To Look Weaker Than China**

**Risks:** In our view, the sector risk in Hong Kong is gradually rising, underpinned by the expected U.S. rate hike, increasing supply, slowing retail market, and economic uncertainties in China, which could affect the investment appetite of mainland investors. We anticipate gradual price correction in 2016 based on our observation of the slowing primary sales and secondary transactional volume. Nevertheless, developers generally continue to have significant recurring leasing income and strong end-user demand as well as low unemployment will continue to support the market in the near term.

In Indonesia, uncertainties around the slowing economic growth prospects, continuous volatility of Indonesian rupiah, and the lingering effects of government-led initiatives to enhance tax collection and reduce tax delinquencies are the key risks to the sector.

**Opportunities:** We believe risk for the sector in China is decreasing because of recovering market sentiment and sales performance, and our expectation that Chinese government will continue to release supportive measures. Sales momentum and profitability compression are still the key risks for leverage to improve, although the pressure is decreasing and is less likely to deviate from our base-case forecast.

### LATIN AMERICA

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<td>A decrease in occupancy rates because of weaker performance at retailers could hurt shopping malls’ revenues and profitability, although we don’t see this as a major risk for the rated premium mall operators in the region.</td>
<td>Amid our expectation of weakening demand and cash flows, combined with weaker credit conditions and limited access to capital markets, we see increasing refinancing risks for Brazilian players.</td>
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<td>As opportunities, we see the potential for land acquisition for future projects at lower prices than registered in recent years because of weaker macroeconomic conditions in the region.</td>
<td>For Mexican homebuilders, the main risk could be over reliance on government subsidy programs, what could compromise future cash flows in case the government decides to change/reduce these programs or if the government delays subsidy payments.</td>
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OTHER REGIONAL DEVELOPMENTS

Gulf Cooperation Council (GCC): Sluggish outlook for 2016

Given the role of oil in the region, economic growth and investments in the GCC is likely to slow down further in 2016. We expect governments to cut or postpone expenditure to manage tight fiscal budgets.

While population growth is fundamentally supportive for residential real estate, the segment in Dubai has come under pressure and we expect rents to fall marginally in 2016. Home prices have already seen more than 10% correction in Dubai this year.

We expect polarization of the market to remain pronounced in the office segment where we observe some oversupply, while rents should be stable for prime office locations.

Weaker Euro and Yuan may also impact tourist arrivals which is a key driver for the UAE and more importantly for Dubai (Emirate of). Hotels across the region have been experiencing weakening average daily rates albeit stable occupancies. We expect this languid growth environment to continue in Dubai in 2016 given new hotel capacity expected to be delivered next year.

In the medium-term, tourism should remain an important source of market growth spurred by Dubai’s Expo 2020 and Qatar’s Soccer World Cup 2022. The possibility that the U.S. will gradually lift sanctions on Iran could also support the real estate market in the region.

There is speculation around rollout of taxation laws across the region. While this may create short term uncertainties, it will help the economies to be competitive and provide additional source of income.

Israel

We believe the ability of Israeli rated real-estate companies to increase rents in the near term will be limited in light of the slowdown in private consumption. We expect same-properties NOI in 2016 to 2017 to be stable or slightly lower compared to 2014 to 2015. Nevertheless, we believe rated companies will be able to absorb a small reduction in NOI without significant erosion in their coverage ratios.

We expect to see further increases in home prices in 2016 supported by the still-low borrowing costs which are likely to continue to provide some support to demand for housing. On the other hand, government reforms to improve affordability for young couples, very high housing prices (reflected in price-to-rent ratio well above long-term average) and increase of investor’s purchase taxes are expected to slow down house price growth in 2016.

In commercial real estate, we expect to see a decline in rents in the next few years, as a result of a critical mass of new office construction, especially in Tel-Aviv and its surrounding area.

An enduring deterioration in the geo-political situation in Israel could exert negative pressure on ratings.
FINANCIAL POLICY SUMMARY BY SEGMENT

U.S. HOMEBUILDERS: For U.S. homebuilders we generally foresee a steady recovery lasting several years. Therefore, they are likely to issue debt in 2016 to purchase lots for the current and coming years. We also expect additional borrowings to fund mergers and acquisitions as better capitalized companies acquire smaller competitors to expand their footprints.

U.S. REITS: Debt issuance in the U.S. has been far below last year's record levels, partly because of recent market volatility. Rated REITs issued an aggregate of about $25 billion of new debt issues through November 2015 versus a total of $37 billion in 2014. Despite expectations for a modest increase in interest rates in the near term, we expect REITs to continue to have good access to capital markets given that interest rates remain low by historical standards. We are projecting the 10-year treasury-Note (T-note) yield to reach 2.4% in 2016. REITs have taken advantage of the capital markets to refinance debt maturities and lock in lower financing costs. As a result of proactive refinancing, we think debt maturities are well laddered and manageable in 2016 and 2017, with about $10 billion of debt maturing each year.

EUROPEAN REITs: The current supportive market conditions and rise in valuation has resulted in constant improvement in loan-to-value (LTV) ratios. We believe this provides some headroom for credit metrics should the market conditions deteriorate and property valuation drops. We also note that most REITs have kept a high level of interest hedging and extended their debt maturity profile in recent years.

EUROPEAN HOMEBUILDERS: So far, debt reductions have been limited because of lower free cash flows in the case of developers. But growing revenues from projects deliveries should sustain credit ratios in 2016.

APAC REITs: Generally many of the rated entities retain sufficient buffer within their financial policies to take advantage of debt-funded opportunities or deal with unexpected economic or financial shocks. Rising interest rates are of particular concern, given that the REITs maintain a portion of their debt holdings at a floating interest rate and interest is one of their largest expenses in their cost base. In light of the potential for interest costs to increase, a number of our rated issuers have sought to lengthen their debt-maturity profiles and take advantage of onshore and offshore debt markets.

APAC HOMEBUILDERS: Milder growth expectation in China and flat sales growth in Indonesia would lead to slower capital expenditure growth for most property developers we rate in the region. China and Indonesia have lowered interest rates recently and we have not ruled out further rate cuts. The lowered interest rates have spawned a greater demand in domestic bond issuance, aiding developers' debt maturity profiles and funding costs. As such, most players in China have sufficient buffer or financing flexibility to absorb the potential impact of the expected gradual hike in U.S. interest rates.

LATAM REITs: Most of the rated entities maintain a prudent approach to leverage, with low debt levels compared with operating cash flows. Under the uncertain macroeconomic conditions in Brazil, the players are reducing or postponing investment plans, with limited new launches, in order to preserve cash. Different from other jurisdictions, dividends in general are flexible and could be reduced under a scenario of weaker cash flow generation.

LATAM HOMEBUILDERS: Brazilian issuers have significantly reduced investments amid weak demand in the segment, and have been trying to monetize receivables and inventories in order to improve cash flow generation and liquidity. Potential IPOs from Mexican players in 2016 could drive more aggressive growth strategies and higher dividend payments.
CHART SUMMARY FOR GLOBAL REITS ONLY

**CHART 15 | CASH & EQUIVALENTS / TOTAL ASSETS**
- Global REITS - Cash & Equivalents/Total Assets (%)

**CHART 16 | TOTAL DEBT / TOTAL ASSETS**
- Global REITS - Total Debt / Total Assets (%)

**CHART 17 | FIXED VS VARIABLE RATE EXPOSURE**
- Variable Rate Debt (% of Identifiable Total)
- Fixed Rate Debt (% of Identifiable Total)

**CHART 18 | LONG TERM DEBT TERM-STRUCTURE**
- LT Debt Due 1 Yr
- LT Debt Due 2 Yr
- LT Debt Due 3 Yr
- LT Debt Due 4 Yr
- LT Debt Due 5+ Yr
- Nominal Due In 1 Yr

**CHART 19 | RENTAL REVENUE GROWTH**
- Global REITS - Rental Revenue Growth (YOY%)

**CHART 20 | RETURN ON CAPITAL EMPLOYED**
- Global REITS - Return On Capital (%)

Source: S&P Capital IQ, S&P Ratings calculations
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- Industry Economic And Ratings Outlook: The Credit Outlook For North American REITs Is Positive Even Amid Looming Interest Rate Hikes; Fundamentals Remain Favorable, Nov. 15, 2015
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