

Homebuilders and Developers

Resilient demand to spur recovery

January 9, 2024

This report does not constitute a rating action.



What's changed?

Housing demand remains resilient in the U.S. Mortgage rates increased close to 8%, further hurting affordability. However, low existing home inventories supported homebuilders.

Access to financing could remain difficult in Europe. Banks are tightening lending conditions, especially for commercial real estate developers, which could face elevated refinancing risks.

Brazil announced several changes to its housing program. We expect a higher number of launches due to changes to the Minha Casa, Minha Vida housing program.

What are the key assumptions for 2024?

U.S. cycle times are shorter. Cycle-time reductions enable homebuilders to prioritize returns through higher asset turns and increased delivery volume.

China's property sales value drops 5%. Provincial capital cities and lower-tier cities will see sales value decline 3% and 9%, respectively, alongside lower prices and volume drop of up to 5%.

Latin America and Europe improve profitability. Margins will likely recover more evenly in 2024, given stable inflation and higher-priced projects. In Europe, demand stymies the rate of recovery.

What are the key risks around the baseline?

U.S. existing home inventories increase from low levels. Lower mortgage rates could attract existing homeowners to sell, possibly siphoning sales from prospective new-home buyers.

Europe sees further monetary tightening. More-restrictive conditions could cause banks to issue fewer mortgages, dragging down housing purchases and developers' sales further.

China rolls out policies to support sales in higher-tier cities. Relaxing home purchase restrictions, mortgage rates, and downpayment requirements could aid sales in certain cities.

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Ratings Trends: Homebuilders and Developers

Chart 1
Ratings distribution

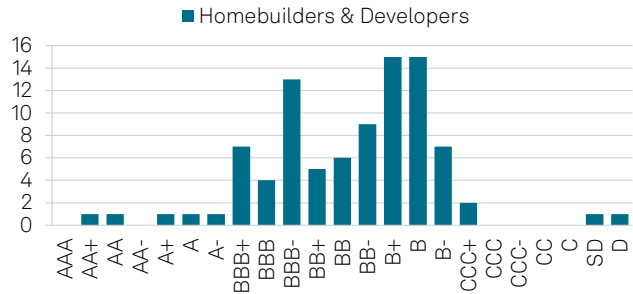


Chart 2
Ratings distribution by region

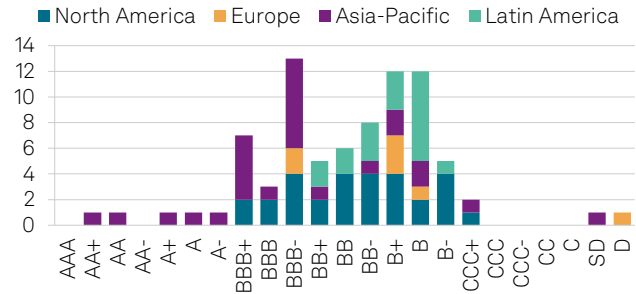


Chart 3
Ratings outlooks

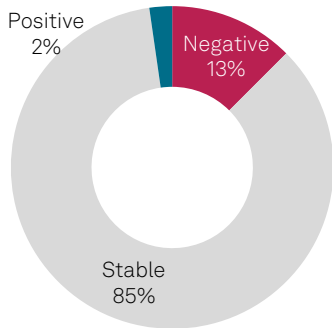


Chart 4
Ratings outlooks by region

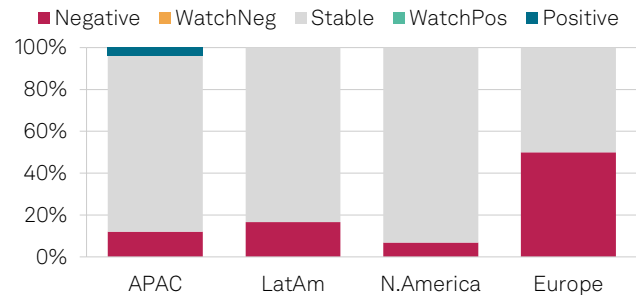


Chart 5
Ratings outlook net bias

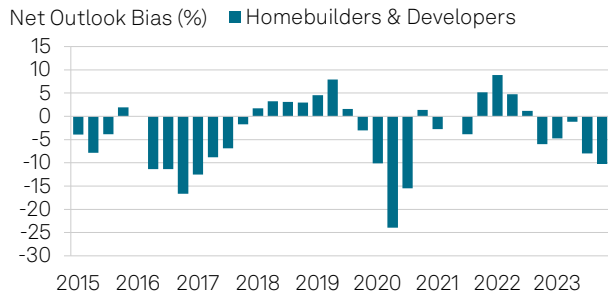
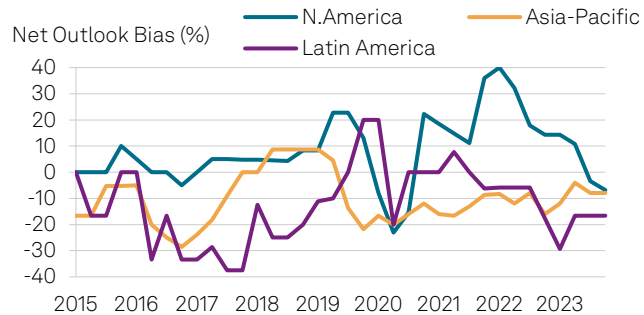


Chart 6
Ratings net outlook bias by region



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

Industry Outlook: U.S.

Ratings trends and outlook

Our overall outlook for the U.S. homebuilding sector is stable. Of the homebuilders we rate, 93% have stable outlooks and 7% (two credits) have negative, indicating the possibility of two downgrades over the next 12 months. We began 2023 with about 30% of our credits on positive outlook and upgraded 13 credits during the year. Of note, we upgraded two credits to investment grade, bringing the total number of investment-grade U.S. homebuilders to seven out of 28. We also rated one new public homebuilder. After the upgrades of 2023 and with no credits currently on positive outlook, we expect minimal upgrades in 2024.

Despite a stable outlook and our expectation for declining revenue and EBITDA growth in 2023, the sector benefits from good long-term demand, tight supply, low existing home inventory, a healthy labor market, good cost management, and judicious capital allocation. Many homebuilders used the windfall from peak operating performance in 2022 to reduce debt and bolster land to improve their balance sheets.

As of Jan. 1, 2024, we publicly rate 28 issuers in the U.S. homebuilding and real estate developer sector. Issuers' revenues range from \$640 million to slightly over \$33 billion. Currently, 25% of our ratings on U.S. homebuilders are investment grade ('BBB-' or higher) while 39% are rated 'B' or lower. Of our rating outlooks, all except two credits are stable, both of which are negative.

Main assumptions about 2024 and beyond

1. Shorter cycle times

Cycle time reductions are enabling homebuilders to prioritize returns through higher asset turns and increased delivery volume.

2. Reversal of revenues and EBITDA declines from prior year

We expect better operating performance in the second half of 2023 to continue into 2024 with year-over-year growth in both revenues and EBITDA.

Construction cycle times decreased in the second half of the year, reflecting improvements in the supply chain. We expect this will increase cash flow and inventory churn. This improvement should play out in overall operating performance as we assume financial results improve significantly from 2023 based on our previous forecasts. In 2023 we expect our rated universe of homebuilders' revenues and EBITDA to decline about 7.5% and 21%, respectively, which is better than the respective declines of 17% and 35% that we projected in July. In 2024 we anticipate revenues grow about 5%, with EBITDA increasing about 6.5% for our rated homebuilder universe. As we anticipate cycle times will improve, we concurrently expect those numbers to expand with them.

Credit metrics and financial policy

Financial discipline for homebuilders before and during the pandemic yielded stronger ratios and a growing credit buffer, indicating their credit quality improved. We expect most homebuilders to sustain solid credit protection measures with robust profitability and lower debt levels, given the cushion under their existing credit metrics and the continued improvement in construction cycle times.

Before taking any negative rating actions, we would anticipate an increase in debt levels through incremental financing and a decline in cash balances that reduce the credit buffer. This could occur through a significant increase in land and land development spending, including small bolt-on acquisitions. Alternatively, a decline in EBITDA could reduce the buffer, but we instead anticipate EBITDA growing about 6.5% in 2024 for our rated universe.

We believe larger public homebuilders have an inherent competitive advantage over smaller builders due to the high cost of capital. Smaller, private, new homebuilders tend to borrow from local and regional banks. Their borrowing costs are generally higher than the larger public builders, and we think the local and regional banks will likely reduce the amount of credit they are willing to extend to the smaller, private builders. This bodes well for mergers and acquisitions (M&A), but we expect to see more land purchases and small bolt-on acquisitions than any large, public M&A activity.

Key risks or opportunities around the baseline

1. Higher-than-expected input costs

Cost inflation continues to challenge the market. However, lower lumber costs have offset some higher input costs. If input costs trend higher than we expect while lumber prices increase, margins could deteriorate.

2. 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.

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

The level of incentives that builders offer helps them maintain sales pace but also pressures profitability. If the level remains higher than normal, we expect pressure on gross margins.

Cost inflation could impair profitability as input costs continue to rise, specifically for lot prices. However, low lumber prices are offsetting most of these costs after declining about 65% since February 2022. While we assume revenues will increase in 2024, if input costs trend higher than expected and lumber prices increase, we expect some deterioration in margins.

A reduction in resale competition is likely increasing the prospective buyer pool for new homes, and we believe this will persist while 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 National Association of Homebuilders. 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 further compounding the limited resale market. It 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 a more affordable option than newly built.

The rise in mortgage rates over the past year has led to higher monthly mortgage payments.

Consequently, homebuilders that provide a rate buy-down incentive strategy have been a key component in mitigating those higher mortgage rates in addition to reducing the size of homes to be sold, providing better affordability for customers while maintaining a targeted sales pace for homebuilders.

However, these incentives have been offered at higher levels than before the pandemic, resulting in a decline in profitability. If mortgage rates begin to decline, which we began to see in December with rates closer to 7%, and remain at these lower levels, we expect a decline in the utilization of these incentives, aligning to pre pandemic levels. All else the same, this could help stabilize margins. However, at the current level of higher-than-normal incentives, we continue to expect pressure on gross margins.

Industry Outlook: EMEA

Ratings trends and outlook

We continue to anticipate significant credit rating pressure for developers in 2024, mainly from subdued demand and elevated cost of construction. However, we expect this to gradually ease during the year. Additionally, we see Spanish developers faring better than average, as demand is less vulnerable to rate increases.

In Europe, four of six (67%) ratings have a negative outlook, highlighting pressure from declining demand for newly built properties amid rising interest rates and significantly higher building costs since the beginning of 2022. Numerous bankruptcies of non-rated companies have occurred this year, as well as the downgrade of Signa Development Selection AG (D/--), the commercial property development subsidiary of Signa Holding GmbH (Signa). Signa was one of the largest private real estate investment companies in Austria, where it filed for insolvency because it was facing a substantial liquidity crunch.

Main assumptions about 2024 and beyond

1. Demand for newly built residential properties to remain low but could gradually recover

The stabilization of central rates, increase in real income, and growing preference for energy efficient assets should progressively revive demand for newly built assets. We expect price declines to slow as developers consider new launches and revive demand. We anticipate a strong labor market and housing scarcity to support prices.

2. Access to financing to remain difficult, particularly for commercial real estate

European banks are tightening their lending conditions, especially for developers of commercial real estate, which we believe could face more elevated refinancing risks. We also anticipate high lending rates to still bear on demand, notably from first-time buyers.

3. Construction cost pressures to ease

The cost of most building materials has stabilized in 2023 and subcontractors have adjusted their prices amid weaker demand. Developers should therefore see margins benefit in 2024 and 2025.

Higher rates and inflation have dented real estate purchasing power and depressed demand for real estate.

In Europe, mortgage loans pay most sales, except in Spain, where the proportion is smaller. We believe the European Central Bank (ECB) will maintain its deposit facility rate at 4% in the first half of 2024, after a 450 basis point (bp) increase within the last 18 months. We expect the ECB to decrease it by 75 bps in the second half of 2024 and by 125 basis points in the first three quarters of 2025, to about 2%. At the same time, real incomes could rise in 2024 because of disinflation and resilient labor markets. We believe both factors will revive demand and limit price declines this year (see chart 7). Moreover, we anticipate Spanish developers will experience less stress, as their sales have support from cash transactions, mortgages with low loan to values, and more international demand.

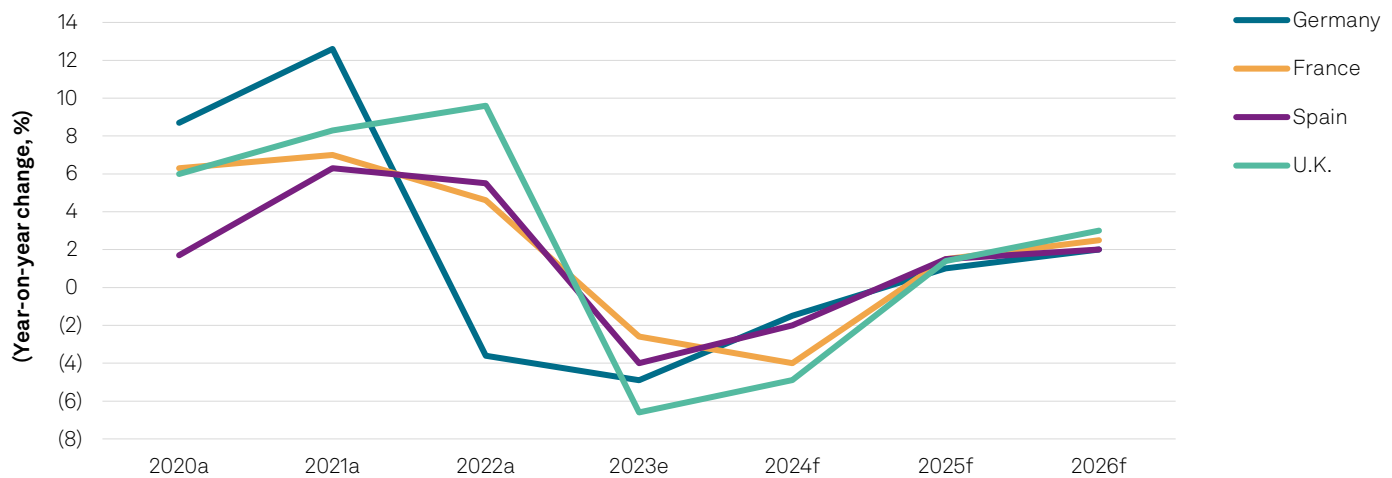
We view commercial real estate developers as vulnerable to refinancing risks. This is because obtaining bank financing on new property developments, especially speculative ones that are not pre-let and riskier by nature, could become harder (see "[Credit FAQ: Spotlight On Refinancing Risks In European Commercial Real Estate](#)", April 24, 2023).

Margins continue to experience heavy pressure, reflecting weaker prices as demand suffers and persistently high construction costs as developers lower selling prices to sustain sales volumes. However, the cost of raw materials, such as steel, aluminum, timber, energy, and water, has significantly moderated compared to its peak in the end of 2022. Moreover, some subcontractors have readjusted prices further to accommodate a weakening demand. Therefore, developers' margins could improve in 2024 given the lag from contract renegotiations, though remain lower than in 2021.

Chart 7

S&P Global Ratings economists' nominal house price forecasts

Year-on-year change in Q4 (%), as of July 20, 2023



a—Actual. e—Estimate. f—Forecast. Source: S&P Global Ratings. Economic Research: European Housing Markets: Sustained Correction Ahead, July 20, 2023.

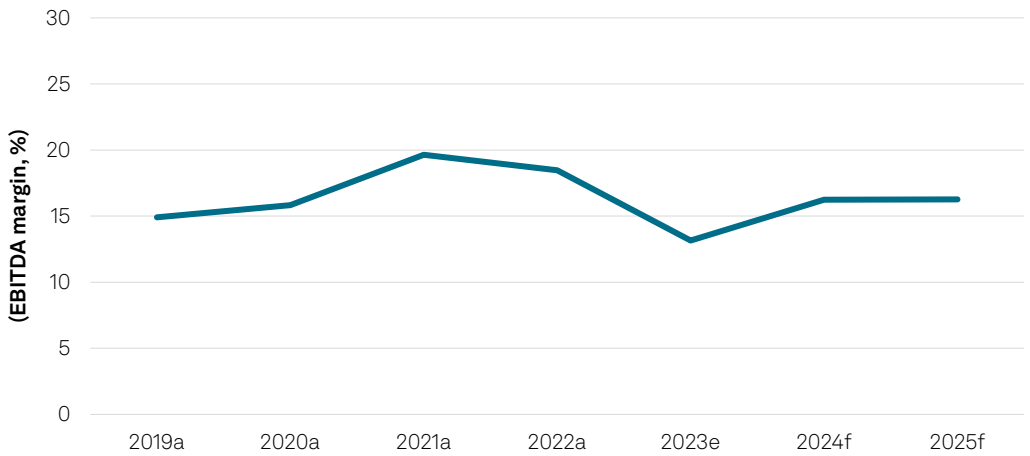
Credit metrics and financial policy

Revenue could recover modestly in 2024, after a strong decline in 2023. We expect EBITDA margins to improve due to easing construction cost inflation and potentially stronger sales (see chart 8).

Chart 8

Pressures on EBITDA margin could ease in 2024

Average S&P adjusted EBITDA margin for S&P Global-rated homebuilders & developers (EMEA), as of Dec 7, 2023



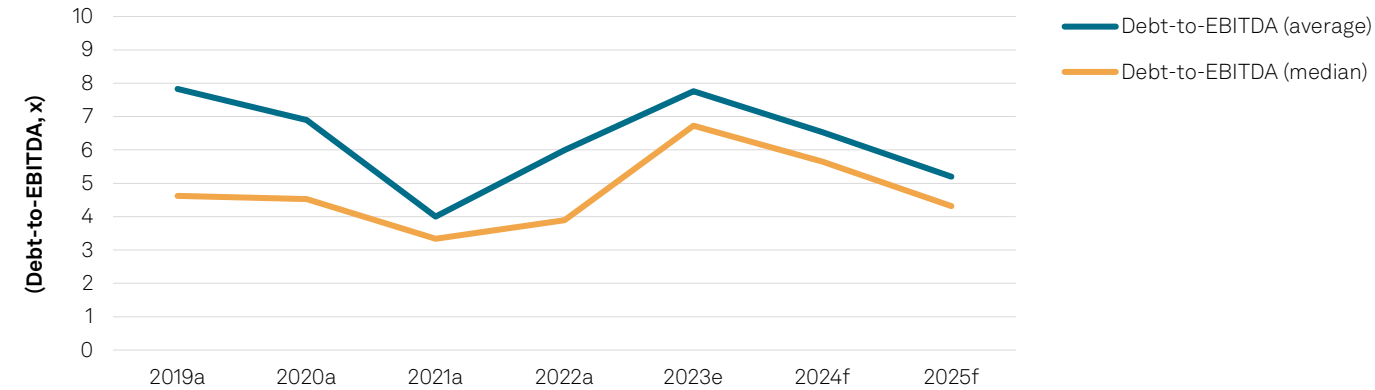
a—Actual. e—Estimate. f—Forecast. Source: S&P Global Ratings.

We do not expect leverage to recover before the end of 2025, as demand gradually increases and new debt supports new project launches (see chart 9).

Chart 9

Debt-to-EBITDA Should Recover Progressively

Average and median S&P adjusted debt-to-EBITDA ratio for S&P Global-rated REITs, as of Sept. 21, 2023



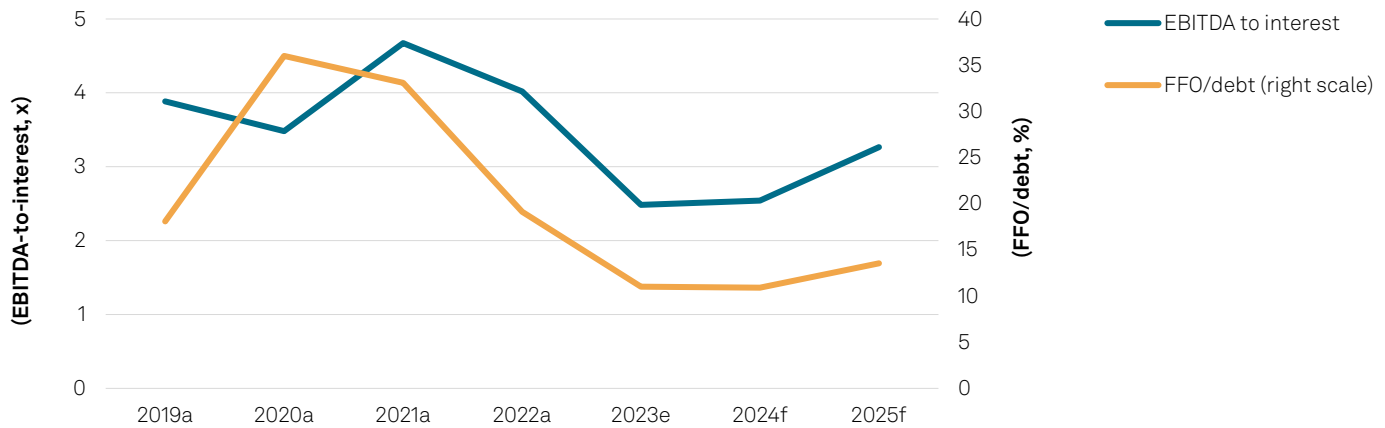
a—Actual. e—Estimate. f—Forecast. Source: S&P Global Ratings.

Interest coverage and funds from operations (FFO) to debt could bottom out by the end of 2024 because of fragile demand recovery and funding costs stabilization, although they will likely remain lower than 2020-2021 levels for a prolonged period (see chart 10).

Chart 10

ICR and FFO-to-debt should bottom out in 2024, as revenue slowly recovers

Average S&P adjusted EBITDA-to-interest ratio and FFO-to-debt ratio for S&P Global-rated REITs (EMEA), as of Sept. 21, 2023



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

Key risks or opportunities around the baseline

1. Further monetary tightening

More-restrictive bank conditions could cause banks to issue fewer mortgages, dragging down housing purchases and developers' sales further.

2. Intensifying regulatory and environmental requirements

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

3. Support from government

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

Developers' sales and price flexibility could be weakened if banks tighten lending conditions, either in pursuit of increased margins or because of higher-than-expected rate increases by central banks. This is especially likely in countries where rates are variable or where servicing household debt represents a high burden, such as the Netherlands, Sweden, and the United Kingdom (U.K.).

Environmental requirements could be either 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 residential. 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.

In 2023, governments showed only little support to the sector--mostly through incentives to renovate and small-scale bulk acquisitions. In contrast, some strong historical incentive programs, such as the U.K.'s Help to Buy scheme or France's PINEL system, have been halted or won't continue in 2024. We think more support from governments could significantly incentivize the purchase of newly built assets and boost the performance of property developers.

Industry Outlook: Other EMEA

Gulf Cooperation Council

In the United Arab Emirates (UAE), residential real estate developers are benefitting from robust demand. Dubai is particularly strong, defying global trends and remaining relatively immune to high interest rates, inflation, and uncertainty around the fallout from geopolitical conflicts. After three years of double-digit percent growth in real estate transaction numbers, prices, and rentals, the average price has approached peak levels of 2014, increasing cyclical correction risks.

We think prices for Dubai's property market could start to stabilize and even decline slowly over the next 12-18 months if lingering global economic pressures undermine sentiment and demand, while a high level of new supply leads to market saturation. High interest rates had a limited effect on demand in Dubai, where the bulk of real estate transactions are paid in cash and the share of mortgage transactions dropped to only 16% of all transactions in the first nine months of 2023. We expect a mild slowdown and believe developer ratings will remain resilient with support from reduced leverage, accumulated cash balances, and hefty liquidity buffers.

In Saudi Arabia, strong demand for residential real estate in the capital Riyadh and Jeddah led to price increases. Megaprojects related to the Vision 2030 plan have significantly activated the market and expats and local Saudis are relocating in Riyadh, which actively attracts businesses in its quest to become a large regional business hub. However, higher prices and higher mortgage rates are hindering demand as transaction numbers contract. However, the demand for residential real estate in Saudi Arabia is more sensitive to high interest rates, demonstrated by new mortgages declining year to date in 2023.

The country is almost at its target of increasing homeownership by Saudi nationals to 70% by 2030 (67% as of September 2023). This target, as well as expat population growth, will sustain demand for real estate in 2024. There is still no freehold title to real estate for foreigners in Saudi Arabia, so the real estate market is generally less volatile than in neighboring Dubai, which has a higher share of expats who can purchase freehold properties. Saudi nationals account for about 60% of the population in Saudi Arabia, compared to less than 10% nationals in the UAE.

Qatari real estate is undergoing a cyclical correction after the boost related to the World Cup in November-December 2022. Oversupplied real estate properties have seen price and rental declines, as more new units were delivered in 2023. We expect pressures to persist over the next two to three years.

Israel

The housing market was pressured by a stiff decline in the number of transactions together with higher interest rates. Accordingly, we expect the credit quality of homebuilders and developers to deteriorate, especially small or the more leveraged ones that are more sensitive to the decline in cash flow generation. The rapid and unusual increase of housing prices by about 20% in 2022 and much higher interest rates led to affordability deteriorating further. This results in a whopping 40% drop in the number of transactions year over year as of the end of September 2023. The level of unsold new units as of September 2023 is a historical high and 38% higher than at the beginning of 2022.

Nevertheless, the slowdown in demand translates only to a mild decrease in housing prices of 2.4% in the first three quarters of 2023. The low demand together with much higher funding cost and tighter financing conditions results in a significant decline in land acquisitions by developers and an about 30% drop in building starts. The latest war has enhanced these trends and led to a

slowdown in construction, with a shortage of labor and the volatility of raw material costs following the disruptions in supply.

If lower demand persists, we expect companies to suffer from lower revenue and profitability, given higher interest rates, higher construction costs, and lower sale prices. We expect these trends to translate into lower credit quality, especially for leveraged companies that purchased land at peak prices in recent years (especially in 2021-2022), which are more exposed to changes in prices and financing costs. If the war expands to other regions or lasts longer than we expect, or if the Israeli economy recovers slower than we expect, we expect homebuilders and developers to experience more pressure.

In the medium to long term, we expect transaction volumes and prices to bounce back with the expected recovery in the economy and a low unemployment rate. Our estimation is based on higher construction costs and rents, Israeli demographics that support rigid demand growth, and the potential shortage in supply following the current slowdown in building starts and land acquisitions.

Industry Outlook: Asia-Pacific

Ratings trends and outlook

We believe China's property sales will track an extended L-shaped recovery in 2024. The market will become more polarized, with the state-owned developers increasingly eclipsing the market share of private property firms, and leverage at all entities will stay elevated. In Hong Kong, we expect the credit profiles of rated developers will remain stable amid falling home prices, given their growing non-property development income and prudent land acquisitions. In Indonesia, the credit quality between higher- and lower-rated developers will further diverge in 2024.

Main assumptions about 2024 and beyond

1. China's property sales value to drop 5%

Rounds of policy support aimed at upper-tier cities will stabilize these markets first while lower-tier cities contend with excess supply and weak demand. We expect sales value in the four biggest first-tier cities will rise 3%. Second-tier cities (mostly provincial capital cities) and lower-tier cities will see sales values decline 3% and 9% respectively.

2. Hong Kong's home prices to fall 5%-10%

Softening economic growth, rising interest rates, and near-term oversupply are weighing on Hong Kong's home prices. As sales volumes declined and new supply held steady, inventory started to build. We think prospective homebuyers are reluctant to buy at this juncture. Pent-up demand could release when economic growth stabilizes and interest rates ease.

3. Indonesia residential marketing sales to grow 5%-10%

Supportive regulatory policies and end user demand of landed houses underpins our expectation of sales growth in 2024.

China's property sales could approach a bottom. Based on China's past property cycles, we estimate the country's annual property sales will find a support level at RMB10 trillion-RMB11 trillion. This is close to our sales estimate of RMB11 trillion-RMB11.5 trillion in 2024. In our view, state interventions will stop sales from following a descending staircase--that is, sequential declines over the next three to five years. While first-tier cities will see an increase in sales value despite flat prices, second- and lower-tier cities will decline in sales value as prices fall and volumes drop up to 5%.

In Hong Kong, we expect primary residential transaction volume to moderately rebound. This is on the back of a recent cut in the city's property stamp duties. However, amid high interest rates, we expect annual sales volume will likely not recover to 15,000-21,000 units seen during 2017-2021. We estimate primary transactions will range from 11,000-13,000 units in 2024, from our estimated 11,000 units in 2023.

In Indonesia, the new round of value-added tax (VAT) exemption will help reduce developers' inventory. The newly released supportive policy outlines a phased reduction on VAT from November 2023 to December 2024. Homebuyers will save up to 11% on VAT for residential units priced below IDR2 billion, provided they are handed over to the buyer before the end of 2024. The new policy will support the end-user demand of landed houses, which constitutes the majority of residential marketing sales in Indonesia.

Credit metrics and financial policy

In China, developers will likely continue to discount units to boost sales and cash flow. Slowing sales and margin pressure will take its toll. We estimate that the average leverage (debt to EBITDA) of rated developers will rise to close to 5.0x between 2023 and 2025, from around 3.0x in 2019. State-owned developers have relatively smooth access to funding, while many private developers have difficulty borrowing, especially those already in distress. This will allow state-owned developers to continue to buy land and roll out more saleable resources than their private peers.

In Hong Kong we expect rated developers, which are market leaders in the sector, will likely sacrifice margins to gain market share and meet their contracted sales target. Their margins will, therefore, likely shrink 2023-2025, which could push up leverage. As most rated developers have sufficient landbank in Hong Kong, we expect they will remain prudent in their land acquisitions to control their debt level and leverage.

Indonesian developers have divergent credit metrics between higher- and lower-rated issuers. Developers in the 'BB' rating category could see modest deleveraging in 2024, owing to their good sales growth in the past two years or increasing recurring income. For developers with weaker credit quality, after temporary deleveraging in 2023 from tender offers below par, we expect their 2024 average leverage to revert to 2022's level. This is due to declining EBITDA after lower marketing sales in the past two years.

Key risks or opportunities around the baseline

1. Chinese government still has policy tools to support sales in higher-tier cities

Further policy easing in higher-tier cities, such as relaxing home purchase restrictions, lowering mortgage rates and easing downpayment requirements, could effectively support sales because those cities have better underlying fundamentals, like stronger economies, lower overbuild, and population growth from inward migration. However, this could further siphon off purchasing power from lower- to higher-tier cities. Lower-tier cities, with their deeper inventory overhang, will likely continue to lag for the next year or two.

2. Hong Kong's solid demand for private homes could put a floor to the downturn

The divergence in residential rents and prices suggests real demand for private homes in Hong Kong. While home prices are softening, residential rents have still been rising. In our view, the current turbulence would have to last longer and be substantially worse than our baseline scenario to fundamentally erode residential property demand in Hong Kong.

3. Refinancing pressure on Indonesia developers remains elevated

Refinancing activity will increase through 2024 to address the looming maturity wall in 2025. This may heighten the sector's refinancing risk again, especially for those rated in the 'B' category and below, should their access to offshore funding remain constrained.

Policies in higher-tier cities in China have not eased as much as they can. For instance, there are still some purchase restrictions on eligible homebuyers and maximum home purchases in tier-one and tier-two cities. In our view, this leaves room for future easing.

In the past, policy easing worked possibly too well for the China property sector. The shantytown redevelopment policy boosted China's property sales in 2016, especially stimulating sales in lower-tier cities. National primary sales by value soared 34.8% in 2016, with a 22.5% jump by gross floor area. This time, we think China's urban village renewal programs will be smaller in scope in comparison. Details on such programs are yet to be specified.

Indonesian developers have turned to domestic banks to meet refinancing needs over the past 12-18 months. This trend will likely continue due to the constrained offshore funding environment and heightened borrowing costs. However, domestic banks are unlikely to fully satisfy the sector's refinancing needs, especially to address the offshore maturity of around US\$700 million in 2025.

Industry Outlook: Latin America

Ratings trends and outlook

Our outlook for Latin America (LatAm) homebuilders and developers remains mostly stable. More than 70% of our rated portfolio has a stable outlook and less than 15% a negative outlook, representing a slight improvement from last year. In our view, most of the downside risks we noticed for the industry earlier this year have gradually dissipated amid a fairly better macroeconomic environment, with controlled inflation and declining interest rates. Although overall results have not quite fully recovered compared to past years, we believe the worst has passed for the majority of our rated portfolio, which in turn triggered some positive rating actions.

After one more year of pressured margins in Brazil, we expect homebuilders to post a more consistent recovery starting in 2024, benefiting from a higher mix of post-2021 projects that had comparatively minimal supply-chain disruptions. Also, we expect the recent revision of the National Index of Construction Costs (INCC) methodology will mitigate potential mismatches like we've seen before, better protecting developers' margins. Additionally, we anticipate homebuilders exposed to low-income buyers will benefit from recent changes to the federal housing program. Still, Brazilian homebuilders' margin recovery and cash generation trajectory amid a high interest rate environment will permeate potential future rating actions, both positive and negative.

In Mexico, the stable outlook benefits from homebuilders' flexible business models, geographic and segment diversification, and healthy balance sheets, including low leverage and solid liquidity positions. Despite hikes in Mexico's reference rate and their effect on the long-term yield curve, mortgages rates remain attractive and relatively stable. We anticipate housing starts to stay low but stabilize, while home prices continue to increase, benefiting from a demand that still surpasses the tight supply of units. However, we believe this price increase will moderate as inflation eases. This will help rated homebuilders protect profit margins by passing inflation costs to homebuyers.

However, we highlight the cyclical nature of the homebuilding industry, especially due to economic and political volatility in the region. As such, we remain cautious about the long-term outlook for the sector.

Main assumptions about 2024 and beyond

1. Brazilian homebuilders' launches and sales to benefit from higher investments in the housing program

We expect recent changes in the federal housing program to stimulate homebuilders to strengthen their portfolios in the low-income segment as entities with higher exposure to the segment already show benefits in their third-quarter 2023 results. We expect this to further help operations in 2024, with solid growth in launches and steady sales pace, also boosted by resilient demand amid a still-high housing deficit.

2. Improvements to profitability persist, although cash generation remains challenging

Our base-case scenario indicates margins recovering more steadily in 2024, given stable inflation and projects with higher prices. Still, high level of launches will continue to require higher working capital needs, especially for entities more exposed to mid- to high-income segments. This and a still-high interest burden will continue to pressure cash flows in 2024.

3. Mexico's housing starts stabilize while sales and cash flow growth remains healthy

We expect Mexico's housing production to remain low but stabilize following several years of contraction, amid limited government subsidies and low economic growth. However, we expect Mexican rated homebuilders to deliver solid sales and EBITDA growth in 2024 amid a housing deficit and to use a flexible business model while maintaining credit protection measures commensurate with their credit profiles.

We expect launches from Brazilian homebuilders to increase from a better macroenvironment and higher investments in the housing program. In July 2023, Brazilian federal government announced several changes to the housing program Minha Casa, Minha Vida (MCMV), such as raising the home price ceiling, increasing subsidies to homebuyers, and lowering mortgage rates depending on the family income. Such changes directly affect the operations of homebuilders operating within the segment by increasing the pool of potential homebuyers in the program amid a still-high housing deficit in the country and allowing companies to increase units' prices, potentially reflecting better operating margins. Currently, 10 out of the 11 Brazilian homebuilders we rate have some exposure to the MCMV, and we expect such exposure to increase in 2024 as even entities historically focused on other income segments announce their intention to grow in the MCMV program, given the favorable headwinds for the segment.

Moreover, the macroenvironment has been improving over the year, with our expectation of 1.52% GDP growth in 2024 from projected 2.9% in 2023, coupled with stable inflation and declining but still-elevated interest rates. We expect this to gradually help lift consumers' disposable income and confidence over the next quarters. In such a scenario, we anticipate Brazilian homebuilders to increase the number of launches in 2024 more steadily than in previous years, assuring good sales pace and profitability levels.

Profitability improves overall, but cash generation remains a concern for mid- to high-income homebuilders. Most Brazilian homebuilders are still reporting pressured margins arising from the still-high mix of projects from before 2021, which were hurt more by high inflation. Still, we expect most of those projects to be delivered across 2023 and first quarter of 2024, unlocking the opportunity for profitability improvements through 2024 with the better backlog margin from projects launched or sold from 2022 on. On the other side, we anticipate some companies to struggle with high cash consumption for longer than expected if launches increase, especially for those focused on mid- to high-income segments, given higher working capital needs during the projects' construction phase.

Mexican rated homebuilders' sales and EBITDA margins to remain healthy, with 5%-8% revenue growth in 2024 on the back of low-single-digit percent unit growth and average price increases. We anticipate operating margins will remain resilient as inflation eases, despite higher labor costs. 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 its proven ability to adapt its product offering according to market needs. Rated homebuilders will remain prudent in terms of developments, net cash flows, and debt, which should keep their leverage broadly stable in 2024. We expect refinancing risk will be limited in 2024, due to homebuilders' ample liquidity positions and proactive liability management over the past 12 months.

Rated homebuilders enjoy a solid competitive position in a highly fragmented market that has seen a supply contraction for several years. Housing starts in Mexico reached a historical low, with a decline of 8.7% or 128,368 units in the 12 months ended October 2023. 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. We

expect Mexico's economic activity to slow down in 2024. Alongside a limited federal housing subsidy budget of about MXN4.7 billion, we expect this to keep housing starts low and to stabilize around 130,000-135,000 units per year, below the 2019 level of about 160,000 units per year when the housing subsidy was well above MXN6.0 billion per year.

Still, we expect rated homebuilders to benefit from the housing deficit in the country, supportive demographics in Mexico's young population, and slowly growing formal employment. Although the central bank significantly raised the reference rate since 2022, mortgage rates have remained broadly stable. Moreover, government-owned entity Instituto del Fondo Nacional de la Vivienda para los Trabajadores (Infonavit) committed to freezing rates through September 2024. We also anticipate Infonavit and el Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (Fovissste) will continue expanding their housing programs and customer base, which will incentivize potential homebuyers. We also expect house price increases to moderate, in line with easing inflation.

In our view, these factors support the expected 2024 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-/Stable/--; national scale: mxA-/Stable/--). 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 raise top-line growth and increase their market share in this highly fragmented market.

Credit metrics and financial policy

We expect metrics will gradually improve for Brazilian homebuilders in 2024. Following the 2015-2017 Brazilian economic crisis, the overall housing sector adopted more conservative approaches to leverage and financial policy. Most rated issuers increased cash balances and maintained extended debt maturity profiles, while increasing access to the local debt market. This has led to minimal negative rating actions in 2022-2023, as metrics remained broadly in line with our expectations.

Nonetheless, persistently high interest rates and our expectation of an average basic interest rate of 9.9% in 2024 still weigh on companies' interest burden and coverage ratios, especially regarding already pressured FFO generation given weaker profitability. We have seen some of our rated issuers focus on liability management by refinancing upcoming maturities with better cost lines or by reducing gross debt position for those with a more consistent cash generation cycle.

Additionally, we expect Brazilian homebuilders to continue to rely heavily on construction financing debt or even structured product issuances, as these credit lines usually have better cost and terms. As such, we forecast credit metrics to broadly improve in 2024 for Brazilian homebuilders, with FFO-linked ratios forecast to increase during the next few quarters.

We expect financial policies for Mexican rated homebuilders to remain supportive to key credit metrics, as in the past few years. We assume rated homebuilders continue demonstrating prudent financial policies over the next 12 months, including prioritizing strong balance sheets that support low leverage, maintaining sound liquidity, and making investment decisions subject to its financial position. Moreover, rated homebuilders have proven access to local debt capital markets and credit facilities, which enhances flexibility toward refinancing needs, which we view as low for 2024. Following two years of high investments in land and housing construction, we expect working capital needs to moderate in 2024, which will contribute to expanding free operating cash flow and credit metrics consistent with the ratings.

Key risks or opportunities around the baseline

1. Macroeconomic risks pose downside risks to our forecast on LatAm homebuilders

Economic and political conditions in the region have proven relatively volatile in past years. Such a track record makes us more cautious regarding long-term prospects for the industry in the region, although we expect the macroenvironment to remain relatively stable in the short term.

2. Housing deficit, demographic trends, and access to mortgage loans provide solid medium to long term growth prospects

The region maintains a significant housing deficit, and benefits from a growing middle-class and a mortgage lending sector with well capitalized banks, that provides solid medium- to long-term growth opportunities for the sector.

The LatAm region historically presented more volatility in terms of economic and political conditions, posing mid- to long-term risks for homebuilders. Our base case assumes that both the Brazilian and Mexican economies slow down in 2024. We expect Brazil's GDP to grow 1.5% and Mexico's 1.8%, reflecting lower fiscal stimulus measures in Brazil and subdued demand in Mexico from its main partner, the U.S., despite still-tight financial conditions in both countries.

In our view, weaker-than-expected economic activity coupled with a prolonged period of high interest rates in Mexico could further reduce disposable income and ultimately reduce housing demand, especially in the mid- to high-income segments, which could squeeze homebuilders' capacity to pass through potential cost increases and undermine operating and financial performance if not addressed. In Brazil, we expect a decrease in interest rates to translate into some decrease on mortgage rates, consequently improving homebuyers' affordability. In addition, recent changes on the Brazilian construction cost index and in the MCMV program will further protect home builders' ability to pass through inflation costs to buyers through higher prices.

In Brazil, the housing program is a priority on the current federal government's agenda. Still, we are uncertain about the details of the Lula administration's policies, especially on the fiscal front, which we believe could push back investments until homebuilders gain more visibility regarding such policies.

In Mexico, general presidential elections will take place in 2024 and, although we do not expect a major shift in the country's housing policy in the next 12 months, we recognize it can delay homebuyers' investment decisions until they have more visibility on the country's policy direction.

The housing deficit, demographic trends, and access to mortgage loans provide solid medium-to long-term growth prospects. In many LatAm countries, we observe a significant housing deficit (close to 6.0 million in Brazil and 8.0 million in Mexico) and a growing middle class as economies are slowly increasing, although it will likely remain below historical levels in 2024 and on. Moreover, in Brazil and Mexico, the housing sector benefits from well-capitalized banks and supportive mortgage-lending activities. In Mexico, mortgage rates remain broadly stable, despite volatile reference rates from the central bank. In our view, these provide solid medium- to long-term growth opportunities for the sector.

Moreover, in Brazil the federal government housing program announced new income thresholds for its brackets, aiming to accommodate more families within the program, among other changes. This increases the addressable market for homebuilders that operates with the program. Additionally, the new government already announced its intention to increase the level

of investments in the program, which can present further upside for Brazilian homebuilders operating in the low-income segment.

Related Research

- [Credit FAQ: What Does Property Company Signa's Failure Mean For Ratings?](#), Dec. 12, 2023
- [Credit FAQ: Spotlight On Refinancing Risks In European Commercial Real Estate](#), April 24, 2023

Industry Forecasts: Homebuilders and Developers

Chart 11

Revenue growth (local currency)

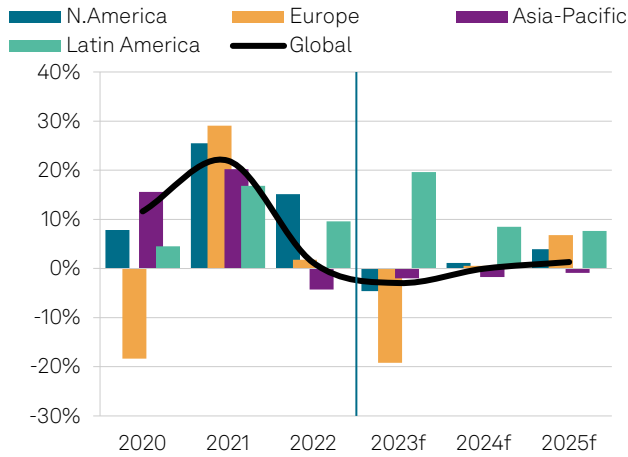


Chart 12

EBITDA margin (adjusted)

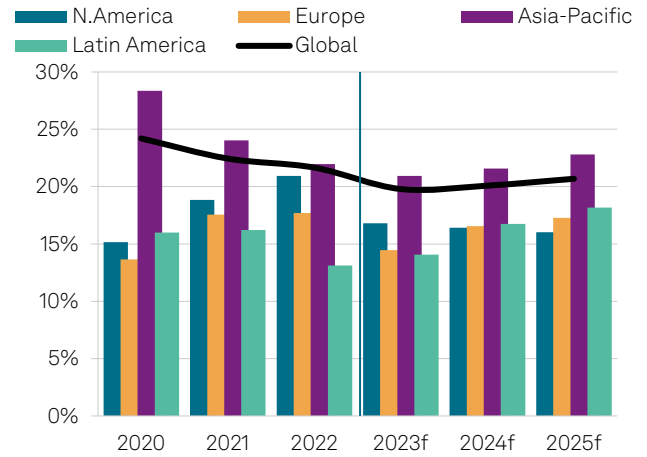


Chart 13

Debt / EBITDA (median, adjusted)

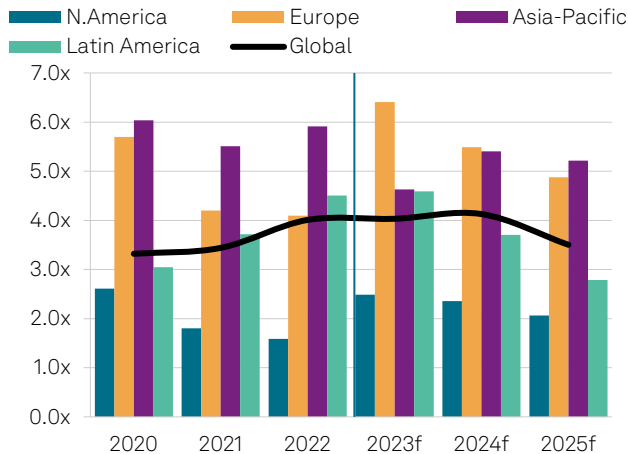
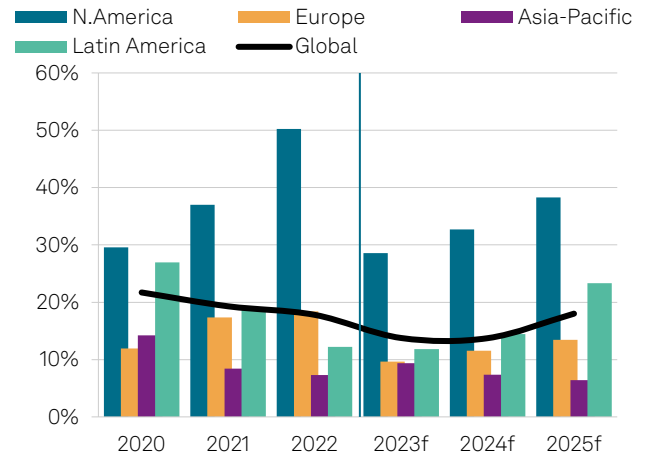


Chart 14

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 15

Cash flow and primary uses

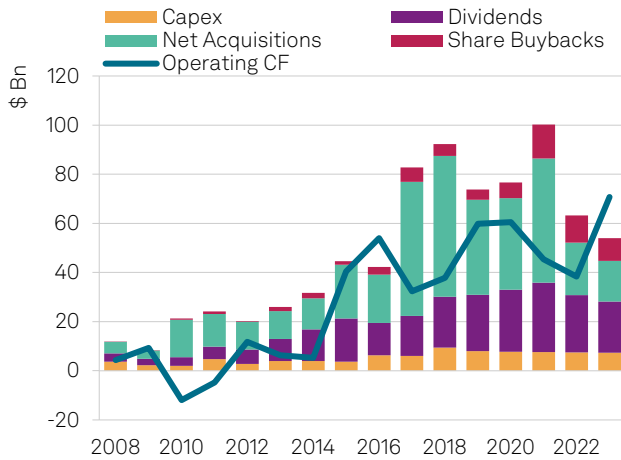


Chart 16

Return on capital employed

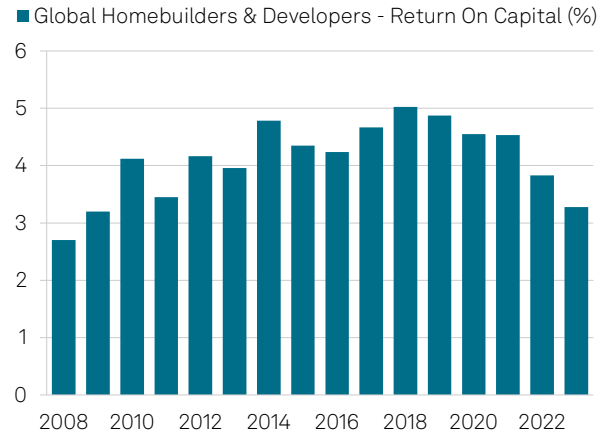


Chart 17

Fixed- versus variable-rate exposure

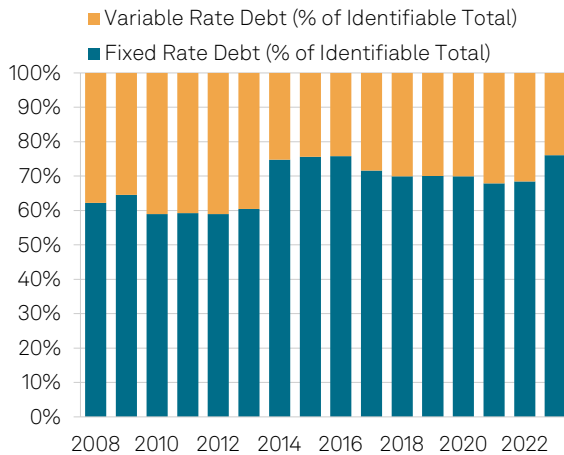


Chart 18

Long-term debt term structure

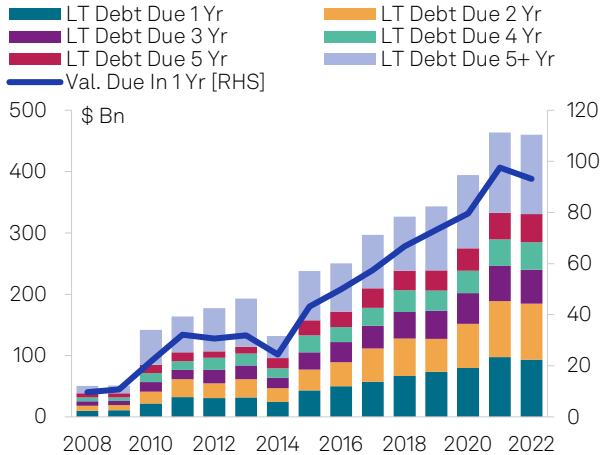


Chart 19

Cash and equivalents / Total assets

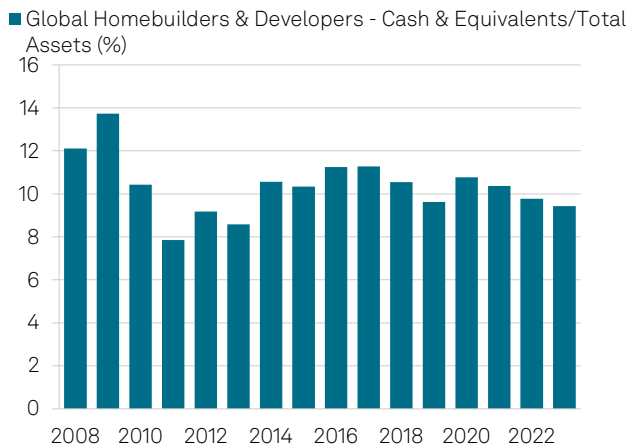
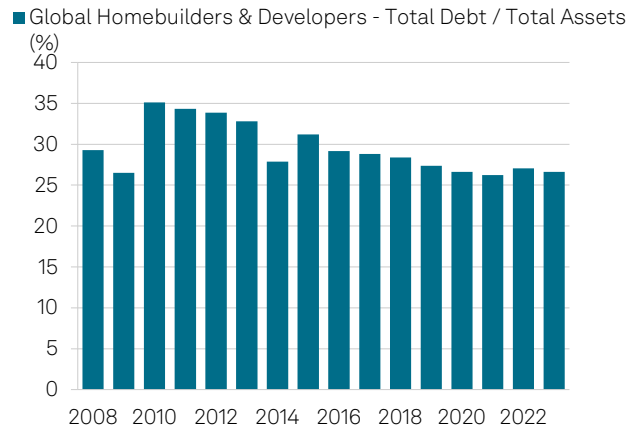


Chart 20

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2023) figures use the last 12 months' data.

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