Industry Top Trends Update

Real Estate

Retail and office REITs have not hit bottom

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What's changed post-COVID?

Growing negative rating bias. We have taken 20 negative rating actions since March, most of which were outlook revisions to negative. Of the entire rated portfolio, 20% have negative outlooks; the negative rating bias is higher for retail REITs at 27%, and 36% for office REITs. Still, real estate remains an 80% investment-grade sector. In addition, REITs entered this downturn in better shape with materially lower debt leverage, increasingly unencumbered asset bases, more staggered debt maturities, and better liquidity compared to the last recession.

Rent collection remains resilient, except for retail properties. Rent collection remains in the 90% area for most property types. However, retail strip centers collected 55%-75% of contractual rent in April and May, and malls collected 15%-40%. We expect significant short-term cash flow volatility for retail REITs.

The pandemic is accelerating the shift to remote working, resulting in gradual reduction in office space utilization. The sustainability of co-working concepts could also pressure the office sector, particularly in gateway markets. However, a potential counter to the reduction of space could be the reversal of office densification.

What is the likely path to recovery?

Declining revenue and EBITDA for most sectors by 10%-15% in 2020 compared to 2019, given lower rent collection and weak leasing activities. For retail REITs, given the impact of mandated store closures, cash flow could decline 20%-30%.

Deferrals, closures, and bankruptcies. Retail assets, particularly malls, received some of the lowest levels of rent among rated REITs and granted a significant number of deferral requests from tenants. If there is an increase in tenant bankruptcies, the amount of write-offs and abatements will rise proportionally.

A multiyear recovery will begin this year as the economy further reopens, resulting in a rebound in revenue and EBITDA in 2021 of up to 10% compared to 2020, but remain below 2019 levels. Still, credit metrics will not fully recover to pre-pandemic levels until 2022.

What are the key risks around the baseline?

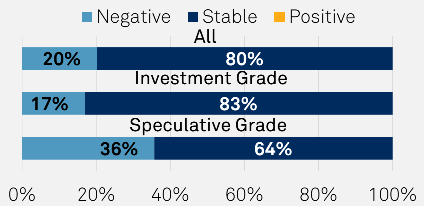
Another economic shutdown from a second wave of coronavirus cases could delay rent payments further and stall the demand recovery for retail or office space. Given the external funding nature of REITs, capital markets volatility (particularly in equity markets or an inability for REITs to sell assets) could also hamper a recovery of credit metrics and result in higher debt leverage than we expect.

A more aggressive financial policy could stall a recovery in credit metrics. We'd expect issuers to adjust share repurchases or dividend distributions if weak operating conditions persist to enhance liquidity and preserve financial flexibility.

Latest Related Research

- Rent Pressure And Development Delays Heighten Risks For U.S. Office REITs, July 2, 2020
- COVID-19 Accelerates Structural Shifts In Global Office Real Estate And REITs, June 9, 2020
- REITrends: Negative Ratings Bias Rises As North American REITs Confront Effects Of COVID-19, May 28, 2020

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	65	14	79
Downgrades	0	4	4
Upgrades	0	0	0

Ratings data as of end-June, 2020

COVID-19 Heat Map

Real Estate (REITs)	
COVID-19, Recession, and O&G Impact	**Moderate**
Potential Negative Long-Term Industry Disruption	**Yes**

2020 Estimates v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
10% to 15%	**10% to 15%**	**5% to 10%**

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
0% to 10%	**0% to 10%**