S&P Global
Ratings

Industry Top Trends 2019

Homebuilders and Developers

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Key Takeaways

- **Ratings Outlook:** Our outlook is mostly stable with over 80% of our ratings with a stable outlook. In the U.S. our outlook is stable with support from a continuing if uneven national housing recovery. In APAC, our ratings have seen some upside earlier due to strong sales growth but momentum has largely faded. We expect selective negative actions going forward due to tightening liquidity and refinancing uncertainties. In Latin America, ratings remain mostly stable bar a few cases in Brazil with negative outlooks due to weaker than expected cash flow. In EMEA, the outlook is generally stable with new-build and presale indicators benefitting from the current upturn in the European economy.
- **Forecasts:** In the U.S., we see continued stable demand and a tight supply of new homes. In APAC, sales growth in China has likely peaked and mild declines could appear. Leading indicators such as price growth and real estate investment have slowed and are pointing to a weakening trend. In LatAm, we foresee steady economic growth, and increasing demand in both Brazil and Mexico. In Mexico, the new administration aims to increase the federal subsidy which will increase the number of housing starts in the market. A robust backlog, growing revenues, and healthy planned deliveries should sustain European homebuilders' credit ratios in 2019. Prospects for developers in Russia and the GCC are generally stable but remain dependent on the oil and gas price environment and currency movements.
- **Assumptions:** Strong fundamental demand drivers (job growth, consumer confidence, household formation) for new homes support our stable U.S. outlook. In APAC, we expect weaker profitability due to more expensive land being developed and price caps in major cities in China. In LatAm, we expect solid top-line growth, broadly stable profitability, and a focus on cash flow generation, while issuers maintain prudent financial policies. In Europe, low lending rates, gradually accelerating economic growth and government incentives should continue to fuel the housing market upturn, with the UK a likely exception.
- **Risks:** In the U.S. the risks to our baseline are a slowdown in the housing recovery and affordability concerns. In APAC, developers in China continue to be constrained by tight credit conditions and increasing refinancing demand. In LatAm, macroeconomic downside risks exist and if they materialize they could undermine housing demand. We also expect Brexit to depress average selling prices in the U.K., with the main impact concentrated on London and the Southeast. We also see a risk that the banking sector may decide to cut its exposure to UK homebuilders and developers next year
- **Industry Trends:** In the U.S. we expect a continuation of the consolidation seen over the past three years. In APAC, we foresee accelerating consolidation as larger developers have funding advantages as well as costs, scale and cost efficiencies. This is despite overall sector weakening and restrictive policies to largely remain in place. In LatAm, a steady macro environment and favorable subsidy budget suggest sustainable growth prospects.

Ratings trends and outlook

Global Homebuilders and Developers

Chart 1

Ratings distribution

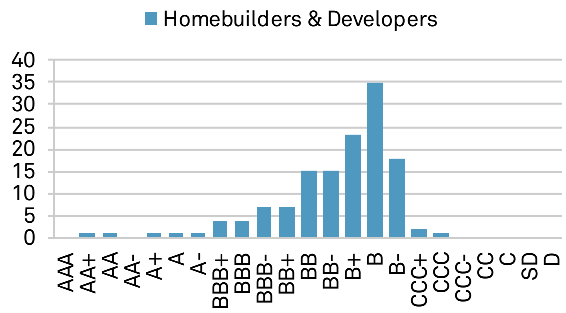


Chart 2

Ratings distribution by region

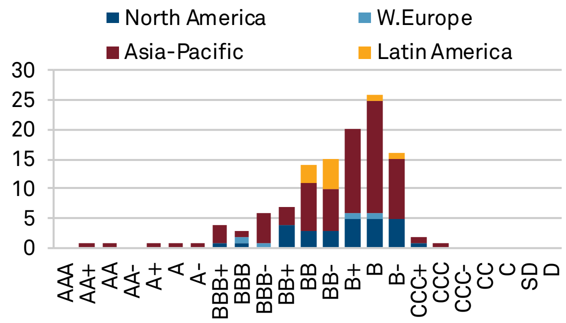


Chart 3

Ratings outlooks

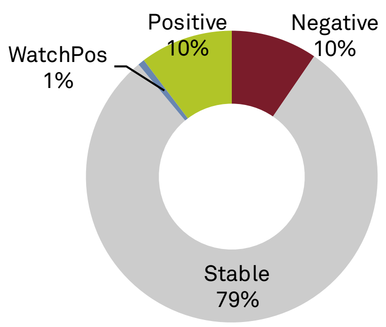


Chart 4

Ratings outlooks by region

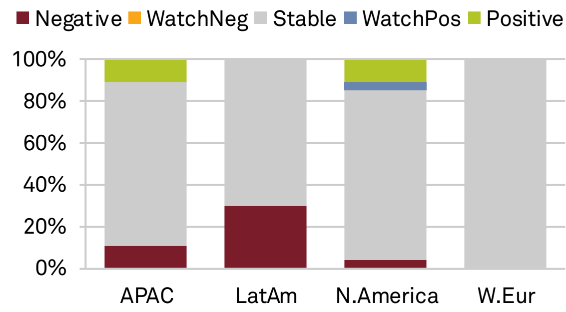


Chart 5

Ratings outlook net bias

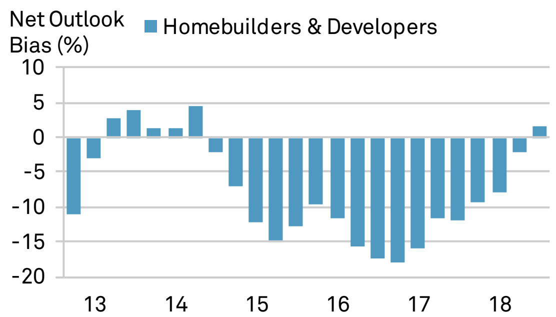
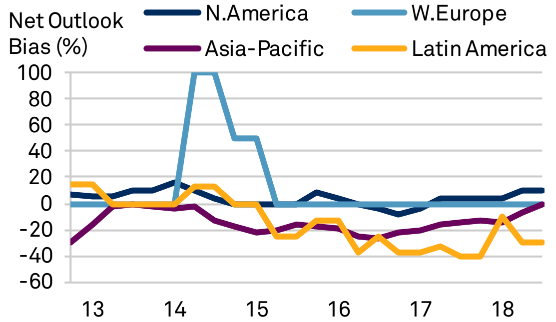


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured quarterly with last shown quarter ending September 30, 2018

U.S.

Our outlook is stable with support from a continued favorable but uneven national housing recovery. We expect most homebuilder ratings to hold steady heading into 2019. Although a few rating changes are probable, our outlook distribution indicates slightly more upgrades than downgrades. About 12% of our rated universe has a positive outlook. Generally speaking, we incorporate solid top-line growth in 2019 into most of our ratings and stable outlooks on homebuilders, due to higher home deliveries and average selling prices.

Asia Pacific

Our ratings outlook for developers is likely to turn slightly more negative in 2019 from more stable. More positive actions this year led to a more neutral outlook bias, but this will likely reverse. As the sales cycle weakens at a time when credit conditions are tight, this may hurt the liquidity profiles of weaker developers in China.

Latin America

Our ratings outlook is mostly stable for 2019. In Brazil, although economic recovery is still slow, improving consumer confidence and credit granting amid lower interest rates support increases in demand. As a result, most homebuilders generate stronger cash flows and increase launches after years of very low levels due to the economic downturn and high sales cancelations. In Mexico, our ratings are broadly stable, reflecting our view of favorable industry conditions for 2019 and the opportunity for homebuilders to capture additional growth opportunities, particularly in the low-income segment. The new presidential administration aims to increase the federal subsidy to tackle the large housing deficit (estimated at around 9 million units). Yet, we expect Mexican homebuilders to sustain their solid financial and liquidity positions.

EMEA

In continental Europe, the ratings outlook is generally stable with new-build and presale indicators benefitting from an economic upturn.

Industry forecasts

Global Homebuilders and Developers

Chart 7

Revenue growth (local currency)

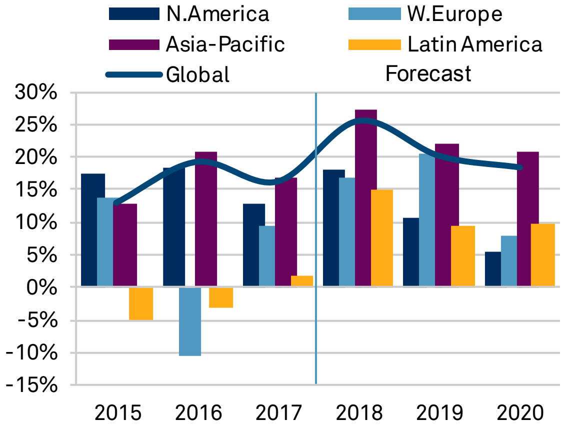


Chart 8

EBITDA margin (adjusted)

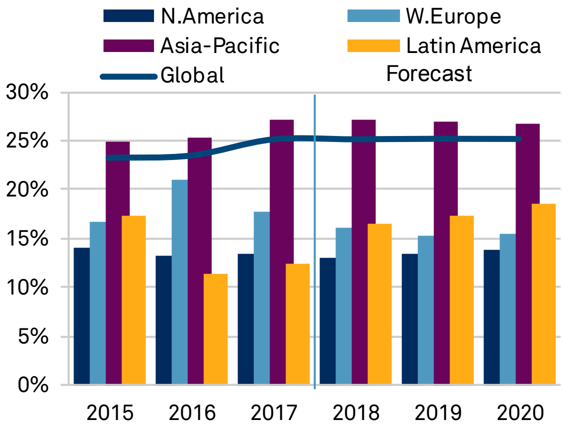


Chart 9

Debt / EBITDA (median, adjusted)

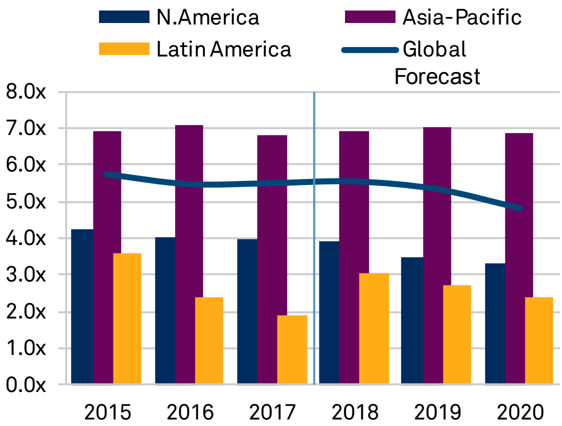
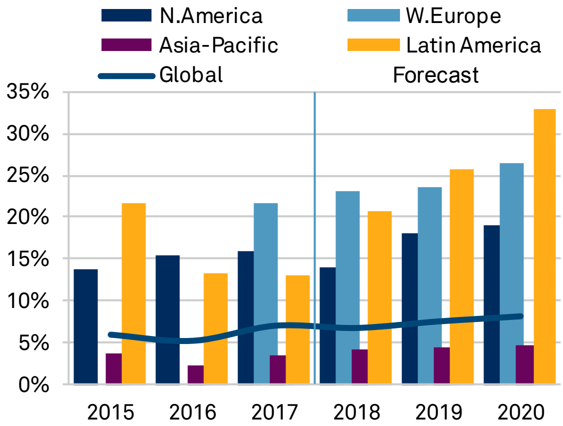


Chart 10

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. 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.

U.S.

Our outlook for 2019 is similar to 2018, with our expectations for continued stable demand and a tight supply of new homes supported by S&P Global Ratings' economic forecast for 1.33 million U.S. housing starts and our opinion that many fundamental demand drivers for new homes will continue to trend positively.

Asia Pacific

We expect property prices in China to drop by up to 5% and volume to decline by 3%-7% next year, likely leading to an overall sector contraction of 8%-12%. Lower tier cities will likely lead the decline, as the slowing economic growth and the overall tighter funding conditions will impact these cities more which have weaker demand.

However, most rated developers should achieve stronger sales than the sector average, as with the previous cycles. The challenging environment will allow larger developers to gain more market shares, as uncompetitive players exit the sector and offer their ditched projects to market leaders for cash.

EMEA

Improving economic conditions across continental Europe, including falling unemployment and higher consumer confidence in the face of moderate inflation, should continue to support revenue growth for developers in 2019. We expect house price appreciation in 2019 to range between 1% for the weaker continental market (Italy) and 4%-6% for stronger countries (Germany and Ireland).

Only for the U.K., where we rate the second-largest homebuilder, Taylor Wimpey PLC, and smaller players like Miller Homers and Keepmoat, do we foresee a low- to mid-single-digit percentage drop in average selling price (ASP) in 2019. Throughout Great Britain's exit from the European Union, we expect the shortage of housing and government measures to provide a buffer for ASPs; declines are likely to be concentrated in London and the Southeast, in particular properties exceeding £1 million.

Latin America

Our ratings outlooks are mostly stable, with only few cases in Brazil having negative outlooks due to weaker than expected cash flow generation. In line with last year, we expect Brazilian homebuilders to show gradual recovery in top-line and cash flow generation amid our expectation of slow economic recovery. In Mexico, we expect industry players to fast-track their growth strategies, particularly in the low-income segment, amid higher subsidy availability, while maintaining broadly stable profitability measures, relatively low leverage, and healthy liquidity positions.

Key assumptions

U.S. Homebuilders and Developers

1. Homebuilding demand trends positively

S&P Global Ratings economists project 1.33 million U.S. housing starts in 2019, about 15% less than the long-term average of 1.5 million. We expect several factors to remain positive heading into 2019: job growth of about 1.1%, wage growth of about 2.9%, increasing household formations, low resale inventory, and high confidence from consumers and builders. We believe these positive demand drivers support our assumptions for higher top-line growth as we assume new sales increase by about 12% in 2019.

2. Housing supply remains low

The low supply of new homes is primarily a result of a relatively tight labor market, trade-driven material price increases, and difficulties in the land entitlement process that can add additional costs and delay the start and finish of a home. Inventory declined to 6½ months' supply from a peak of 12 months in January 2009, according to the U.S. Census Bureau. We do not expect to see a material change heading into 2019.

3. Rate of home price increases slow

From 2010-2018, new home prices appreciated by about 45% (inflation adjusted), according to data from the S&P/Case-Shiller Home Price Index, which we believe is due to inventory decline. As recent housing demand strengthened, we expect the supply/demand imbalance to remain heading into 2019. Consequently, we expect ASP to continue to increase. But as some builders increase their exposure to lower-price, entry-level products and further diversify their product mix, we expect ASP growth rates to decelerate for rated homebuilders.

European Homebuilders and Developers

1. Strong housing market in Germany

Nominal house prices in Germany surged across the country by about 4.8% on average in 2017, the fifth consecutive year of strong price growth. We expect residential property prices in Germany to increase by 3%-4% this year and in 2019, and annual growth to stabilize around 3% thereafter. The economic environment in Germany supports house price growth. Slowing net migration and rising housing supply should simply moderate the pace of annual increases from 2020. Despite land scarcity in city centers, German zoning regulations, and rising construction costs associated with demanding environmental regulations, new supply should reach 300,000 units in 2018 and again in 2019. The Bundesbank estimates that net migration will slow to 400,000 on average per year in 2018-2020 from 500,000 in 2017, easing pressures and contributing to house price moderation.

Still, low interest rates, unemployment rates that keep reaching new lows, and rising real wages with strong domestic demand--combined with a relentless trend toward urbanization--outstrip the new supply of living space in metropolitan areas. We see little sign of a housing bubble developing in Germany. House prices remain fully comparable with those of other European countries and affordable against real income levels or rental yields.

2. Slowdown in the UK

The structural undersupply of housing and government schemes such as the Help to Buy (HTB) program continue to support demand for new homes, in particular in the midrange and affordable housing segments--for which these schemes may account for one-third of overall demand. HTB was extended until 2023 as part of the 2019 budget discussions. Revised rules for HTB mean only first-time buyers and homes within new regional price caps will be eligible from 2021, making ineligible one-third of homebuyers who currently qualify. Nationwide, we foresee a moderate 1%-5% drop in average house prices in 2019. Steeper declines could easily be observed for London and the Southeast, in particular for properties exceeding £1 million. U.K. homebuilders could be affected by the Brexit fallout if demand for new homes starts falling more as purchase decisions are delayed and house prices decline on the back of market uncertainties. Preventive refinancing and low leverage seem the best protections to limit the impact from Brexit.

3. Recovery underway in France and Spain

Market conditions in the rest of continental Europe, especially in France and Spain, are recovering. We expect the trend to continue as long as positive macroeconomic trends combine with sustained penetration of highly affordable mortgage loans, as planned throughout 2019.

In France, we expect house prices to increase by 2.7% this year and 2% in 2019, as households continue to benefit from low interest rates and a resilient economy that is driving strong job creation. Monetary policy tightening, which we expect next year, but a high price-to-income ratio will limit sharp gains in property prices. We expect those trends--backed by a high backlog and reservations--to support French homebuilders and developers' revenues at least throughout calendar 2019. We take into account the new government considering measures to slow price increases in the French residential market. Personal allowances for low-income tenants may be cut further, and the fiscal environment for buy-to-lets is being tightened. Still, structural features attached to the French VEFA system for new home sales ensure high prefunding and should support French developers' credit quality in 2019.

In Spain, the strong economic situation, with unemployment declining and low interest rates, supports the ongoing recovery of the housing market. We expect prices to increase at an annual rate of 5.6% in 2018, down from 7.3% in 2017, and further decelerate to 4.3% in 2019.

Asia-Pacific Homebuilders and Developers

1. Prices no longer buoyant in China, sales growth turning lower

After a long period of robust sales growth from price increases, sector expansion is likely to slow to mild declines in the next 12 months. Price trends are likely to decrease in lower-tier cities as government stimuli wear off and developers use promotional tactics to accelerate sales. Larger developers are likely to fare better with stronger execution and branding, but sales margins unsustainable for most. That said, profitability has substantially recovered, and developers have more buffer to deal with a downturn.

2. Land acquisitions will also taper accordingly in China.

Land market cooling will continue as most developers brace for a tougher environment, leading to further land price decreases. A larger proportion of failed land auctions appeared this year as sales sentiment turned negative. While well-funded developers could take advantage, most will not see the cycle turning. A prime opportunity for consolidation through project acquisitions continues to supply land replenishment and drive growth for larger developers.

3. Hong Kong prices will likely ease

The end of excess liquidity in Hong Kong will likely be the turning point for the property market. As monetary conditions tighten, interest rates will likely continue to rise. We anticipate prices could drop 5%-10% over the next 12 months, from the peak in the third quarter of 2018. Pricing decline expectations and a new vacancy tax for completed but unsold properties, will likely push developers to prioritize sell-through over pricing.

Latin America Homebuilders and Developers

1. Mexican homebuilders are poised to deliver solid top lines growth

With new President Andres Manuel Lopez Obrador's government taking office in December 2018, Mexican homebuilders' growth prospects could accelerate beyond 2019, particularly if the federal subsidy increases to reduce the housing deficit. Under such a scenario, this would provide traction to the low-income housing segment. Rated Mexican homebuilders would thus have the flexibility to increase their participation in this segment. In any case, our forecast suggests that Mexican homebuilders will report solid results through 2019, driven by our expectation of steady macroeconomic environment in Mexico, including GDP growth of 2.4% versus our 2.2% estimate for 2018, inflation rate of about 3.8% versus 4.8% in 2018 on average, and interest rate of about 7% versus 7.75% for 2018. Moreover, industry fundamentals in Mexico remain favorable, primarily supported by the national demographic trend of an emerging middle-class with growth in disposable income, job creation in the formal sector, and the availability of mortgage financing from commercial banks and public financial institutions.

2. Higher launches on gradually increasing demand in Brazil

A gradual recovery in demand allows for monetization of finished inventories mainly in the mid-high income segment, while low-income sales on the government-housing program remain resilient. As a result, we expect increased launches in both segments, but under a prudent approach as most companies recently faced challenging industry conditions during Brazil's economic downturn. Declining unemployment and controlled inflation and interest rates should support adequate credit granting, driving higher sales and cash flows in 2019. While more launches will require higher working capital needs, we believe an adequate sales pace and a more efficient cost structure will compensate.

Key risks and opportunities

U.S. Homebuilders and Developers

1. Slowdown in the housing recovery

Beginning in the third quarter of 2018, data presented mixed signals about the state of the housing market in general and seemed to indicate a slowdown. Sales, permits, and resales all showed decelerating growth rates. New residential sales fell for the fourth consecutive month in September to 553,000, the lowest level in nearly two years. Year-over-year, sales of single-family homes were down 13.2%. Single-family permits increased 2.8% year-over-year in September, the slowest growth rate since the 2.5% in November 2014. In September, total resales were 4.1% lower year-over-year with a sales rate of 5.15 million--lowest since November 2015. Mortgage applications also trended lower, normal considering interest rates are trending higher. Despite those signs of a slowing housing recovery, we still expect job growth of about 1.1% and wage growth of about 2.9% in 2019 on top of our expectations for housing starts to increase about 3.9% to 1.33 million units. Consequently, we expect robust demand heading into 2019.

2. Higher mortgage rates and declining affordability

We believe higher mortgage rates will affect more homebuyers for whom affordability is an issue. As rates rise, monthly payments increase and constrain affordability for those on the margin of deciding to buy their first home. As homebuilders have more recently focused on the entry-level buyer, an uptick in mortgage rates could reduce deliveries and eventually affect builders' credit quality.

3. Gross margin compression

We expect limited prospects for an upside surprise to our base-case earnings forecast, as higher costs for labor, materials, and land mute stronger top-line growth. We expect continued gross margin compression throughout 2019 due to labor constraints and higher labor costs, higher material costs, and a higher cost basis for land as many builders have now worked through low cost inventory that was purchased coming out of the downturn. The cost of lumber declined about 50% since May 2018, which we assume will help offset other costs, impairing margins.

European Homebuilders and Developers

1. Brexit

U.K. developers may be affected by stagnating or falling valuations in certain areas like London as the implications of the Brexit process, especially for the financial industry, become clearer. We believe that Brexit will give financial services firms, already under pressure to contain costs, more reason to consider reducing office space in London. We expect the pressure to be most acute for offices in the City of London or high-end residential properties in London, market segments that have cooled in 2018. As a result, we expect development of commercial properties to slow in the U.K. next year.

2. Political tensions in Spain and in Italy.

In Spain, political tensions surrounding Catalonia's calls for independence have hindered development activities. Persistence of political tensions in Catalonia would likely affect the office real estate market in the region the most. Residential, logistics, or retail segments, influenced by consumer spending more than corporate sentiment, should prove more resilient. Annual 6% growth in home prices in Barcelona compares poorly with the 18% in Madrid this year. Growth in Catalonia might further be contained by political uncertainties throughout 2019.

In Italy, tensions between the Conte government formed in June 2018 and the EU commission around the 2019 budget do not bode well for funding conditions, including for domestic homebuilders.

3. Indirect commodity price dependency in Russia and the GCC

Prospects for developers in Russia and the GCC will continue to depend on the state of those economies, partly driven by the oil and gas price environment and currency movements (see Industry Developments below).

Asia-Pacific Homebuilders and Developers

1. Sales decline more pronounced than foreseen

Recent restrictive policies could instigate a sharper sales decline due to recent economic woes that could lead to weaker homebuyer sentiment. If buyers adopt a more evident wait-and-see approach, such as in the last downturn, sales and therefore cash generation could be dampened more harshly. We generally expect developers to have stable to improving leverage, but this could worsen and dampen their credit standing.

2. Financing conditions do not sufficiently support full refinancing.

If regulatory stance and market appetite do not both accommodate large refinancing needs for the sector, smaller developers could face liquidity shortfalls. Some already took shorter-term funding, which weighs further on their liquidity profiles. Recent negative actions are mostly due to heightened liquidity risk and heavy refinancing burdens. Although these are limited to weak companies with lower competitiveness and high leverage, selective distress situations or even defaults could affect financing for the entire sector.

3. Muted demand in Indonesia.

The key risk continues to be political or regulatory uncertainties during election years. Sales are bottoming out but are muted as buyers stay on the sideline. Many developers are trying to make up the shortfall with block sales of land or units. This could exacerbate gradual credit quality impairment, especially liquidity due to slower than expected sales.

Latin America Homebuilders and Developers

1. Mexico's housing policy to boost growth, but economic risk persists

We believe that during Obrador's administration, the Mexican housing industry could gain traction. Based on proposals of increasing household income to stimulate private consumption, coupled with its policy to increase housing starts to address the deficit, we believe this would help improve industry growth prospects and therefore homebuilders' volume growth. On a less positive note, we believe that macroeconomic downside risks could materialize and drag on their credit quality. If the incoming administration adopts an unsustainable fast-growth model that overheats the economy and triggers a substantial slowdown in the medium term, while market-friendly policies would not be a priority, we believe this could put pressure on several macroeconomic indicators. These would include foreign exchange, inflation, interest rates, consumer confidence, household disposable income, and ultimately housing demand and homebuilders' growth prospects. Moreover, inflationary pressures on building materials costs could pressure homebuilders' operating margins and cash flows, although homebuilders have in recent years partially passed on these cost increases to homebuyers. Obrador recently announced that he plans to cancel construction of the New Mexico City Airport, following a public consultation launched by the incoming administration. In our view, this announcement will trigger volatility and uncertainty that could undermine investment confidence and affect consumer decisions. That may hinder the sector's short- and medium-term growth prospects.

2. Low risk of relevant changes on the government-housing program

We believe that the risk of Brazil's new administration making relevant changes on the Minha Casa Minha Vida (MCMV) housing program is low. This is because of the still huge housing deficit in the country of more than 7 million homes. Also, despite Brazil's relevant fiscal challenges, MCMV subsidies limit weight on government deficits and the homebuilding sector that also contributes to employment levels. As a result, we believe there are opportunities for homebuilders focused on MCMV to maintain constant growth of sales and cash flow generation in 2019. Homebuilders focused on the mid- and high-income segments might face challenges if macroeconomic conditions become volatile, resulting in more strict credit from banks to homebuyers that would likely lead to lower than expected sales and cash flow generation. On the other hand, these players would benefit if the cancelation law, under discussion during 2018, is signed and becomes effective in 2019. This would likely reduce incentives for cancelations by homebuyers and reduce legal expenses that homebuilders face with current unclear rules, leading to fewer cancelations and supporting more predictable long-term cash generation.

3. Mexican and Brazilian homebuilders better prepared for cyclical downturn

The housing industry is local in nature. However, under a hypothetical sharp downturn in the global economy, currency could be significantly devalued in LatAm, leading to higher interest rates to counterbalance rising inflation. If so, consumer confidence could in turn fall along with demand in the homebuilder industry in the region. In Brazil, we believe that homebuilders focused on the mid- and high-income segments would suffer more than those focused on subsidy housing, assuming conditions similar to today. This was the case during Brazil's recent economic downturn. In any case, we believe that Brazilian and Mexican homebuilders are better prepared in terms of operating efficiency, leverage, liquidity position, and financial policies to face another downward trend. In Brazil, companies have strict sales policies, which contribute to lower cancelation rates and more efficient construction processes that avoid cost overruns. Still, weaker cash flow generation due to poor macroeconomic conditions would likely result in liquidity issues for lower-rated entities that don't have relevant cash positions, particularly in Brazil.

Industry developments

In the **U.S.**, we expect mergers and acquisitions (M&A) to continue at a higher pace than 2016 and 2018 after only five transactions in 2016 to 11 so far in 2018. While we do not take a uniform view on M&A and assess each situation individually, the impact on a company's financial risk profile depends on how the transaction is financed and our forecast of its pro forma credit metrics. We would likely view a heavily debt-financed acquisition less favorably. On the other hand, a transaction that enhances a builder's geographic diversity and strengthens its share in local markets could bode well for its business risk profile. We also take transaction size and integration risk into account when considering the ratings impact, which is also situational.

We expect housing price appreciation to slow in both China and Hong Kong after an extended period of strong growth, albeit due to different market factors. In **China**, restrictive policies were implemented over the past 12-18 months aimed at controlling price surges. We do not expect these policies to be loosened significantly and will continue to pressure sector price and volume. However, most rated developers, which are the largest in the industry, could continue to benefit from sector consolidation. Although we expect their sales growth to also taper, most will continue solid sales increases. The risks lie with liquidity management, and weaker companies that have low market standing or short track records may find refinancing costly if not challenging.

The anticipated market downturn in **Hong Kong** is mainly driven by tightening bank liquidity and interest rate hikes. However, this is likely to be mild given fundamental homebuyer demand. In addition, developers in Hong Kong are well positioned given their solid financial positions and diverse business models. The most affected are likely to have high project concentration or be new market entrants that incur steep land costs.

Developers in **Indonesia** continue to be affected by weak demand and sales. Despite declining sales bottoming out, political risks and an uncertain regulatory environment due to national elections in 2019 hold back any meaningful recovery. Developers are positioning toward lower-end products and relying on sales promotions as well as using block sales of land or units to drum up sales.

Latin America

We expect **Mexican** housing starts to rebound in 2018 and beyond, particularly after three consecutive years (2014-17) of sharp contraction, given that the government increased the subsidy level to 6.6 billion pesos (MXN) for 2018 versus MXN4.6 billion in 2017, but still well below the MXN11.5 billion of 2014. For 2019 and onward, we expect better growth prospects for the industry as the new government aims to further increase subsidies for the low-income segment, coupled with the availability of mortgage credit supply for the middle-income and residential segments. Therefore, we expect rated entities to have the flexibility for additional growth opportunities in the low-income segment. Our expectation of steady GDP growth of 2.4% in 2019, normalized inflation rates at about 3.8%, and better interest rates of 7% toward the end of 2019 from 7.75% currently, also bode well for industry growth prospects. Other key industry drivers in Mexico remain related to the large housing deficit, positive demographic dynamics, mortgage loan availability from public financial institutions and commercial banks, and job creation from the formal sector.

In **Brazil**, we expect the housing industry to benefit from a slow economic recovery in 2019, including GDP growth of 2.2% against our 1.4% forecast for 2018. We also expect low inflation rates at around 4% in the coming years and declining unemployment. These conditions should support a better environment for industry growth. Still, with a new presidential administration in 2019 and important reforms on the table, we could see volatile market and credit conditions. We also forecast gradually increasing benchmark interest rates of 8% by the end of 2019 compared to current 6.5% that might increase the average cost of debt for issuers. However, this will likely be counterbalanced by the companies' deleveraging trend.

Russia

The pricing recovery in the Russian housing market remains somewhat slow, constrained by weak personal income growth. Structural demand for housing in Russia remains sustained and should support market volumes in 2019. Due to the real price declines of housing properties over 2015-2016 and lowered mortgage rates, affordability measures in Russia are much more robust. The end of the government's mortgage subsidy program has had no real dampening impact on housing demand.

Gulf Cooperation Council

We expect the residential real estate sector to remain challenging for the next 12 months. Average residential sales prices fell throughout 2018, most prominently in Dubai and Qatar. Residential prices first weakened in 2015 with falling oil prices, and the trend did not reverse even though oil prices recovered and stabilized. More recently, the demand for residential units was affected by heightened geopolitical risk and slower economic growth. We believe supply continues to increase at a faster pace than population growth in the region. Dubai sales prices dropped an estimated 12%-14% in the last 12 months, and we expect this trend to continue in the absence of positive triggers. New under-construction units significantly increased in the last two years as developers offer incentives such as payments after handover and service charge discounts. This means there will be significant new stock delivered in the next 2-3 years, constraining price growth. In 2020, however, arguably the sector might see some benefit from the potential increase in economic activity and positive business sentiment attached to the Expo in Dubai, with our estimate of 25 million or more visitors. We expect positive impact on residential real estate prices to be largely short-lived, as long as the supply/demand mismatch is unaddressed. Qatar's residential real estate prices weakened because of the blockade by a group of governments including Saudi Arabia, United Arab Emirates, Bahrain, Egypt, Libya, and Yemen, which cut diplomatic ties, trade, and transport links with Qatar in June 2017. A near-term recovery in residential prices is not anticipated, unless relations with its neighbors improve.

Despite the challenging market conditions, so far there are few negative rating actions for our GCC-based rated real estate companies, since we factored in potential for market-derived volatility into our ratings. Most companies we rate in the sector also benefit from a high share of more stable real estate rental activities.

Israel

In the past few quarters, signs of continued cooling of the housing market increased mainly following the government's Mechir Lamishtaken subsidized housing program. After a decade of price increases, the housing price index indicates a trend change with the continued decline in demand for new apartments. On the supply side, the slowdown in building starts that began in 2017 is continuing, and in our opinion homebuilders are adapting their activities to market conditions. In the short term, we believe continued stagnation in the housing market will exert negative pressure on prices, with the possibility of moderate price declines, particularly in peripheral areas and in areas with large housing supply. On the other hand, in the medium term, we expect a return of single-digit percentage price increases in demand areas, especially if the slowdown in building starts continues.

Financial policy

Developers in **China** mostly braced for a tougher funding environment by building up strong cash balances in 2017. This proved useful in combatting higher funding costs and redemptions on puttable domestic bonds. Overall, there is moderate leverage improvement given stronger sales and rebounding profitability, more than offsetting higher debt. In addition, most developers decelerated their land replenishing activities due to weaker sales prospects and the more challenging funding environment. These could improve their overall leverage, offset by sales headwinds and margin compression.

Over the past few years, **Mexican** homebuilders generally maintained prudent financial policies toward dividend payments and the use of debt, and we expect this trend to continue through 2019. As such, we foresee Mexican homebuilders maintaining their commitment to low leverage, with net debt to EBITDA around 2x on average, coupled with healthy liquidity positions. Issuers in the sector maintain solid cash holdings, comfortable short- to medium-term debt amortizations, and significant undrawn committed credit lines available. Under the new elected government, we should expect higher housing subsidy availability, which in turn should accelerate low income housing volume growth for most players. However, we expect homebuilders to keep focusing on profitability and cash flow generation. We do not expect market players to significantly change their dividend payout ratios from recent years.

The majority of **Brazilian** issuers already accessed credit markets this year in anticipation of 2019 debt maturities, given political uncertainties related to presidential elections in October 2018, and taking advantage of interest rates lower than in 2017. Still, we expect new debt issuances in 2019 if conditions remain beneficial, either to fund land bank acquisitions and growth of launches, and/or to address future refinancing needs. Overall, Brazilian homebuilders have smooth debt maturity profiles in 2019. With expected stronger cash flows for most companies, some could eventually increase dividend payouts. But we expect leverage to be maintained at relatively stable levels.

In **Europe**, debt reduction for homebuilders is moderate because of limited free cash flows. But increasing revenues from project deliveries should sustain credit ratios in 2019. We also note that most developers have high interest rate hedging and took advantage of recent favorable market conditions to extend their debt maturity profiles. Debt for large rated U.K. homebuilders remains low, providing some buffer in the uncertain context of Brexit.

Cash, debt, and returns

Global Homebuilders and Developers

Chart 11

Cash flow and primary uses

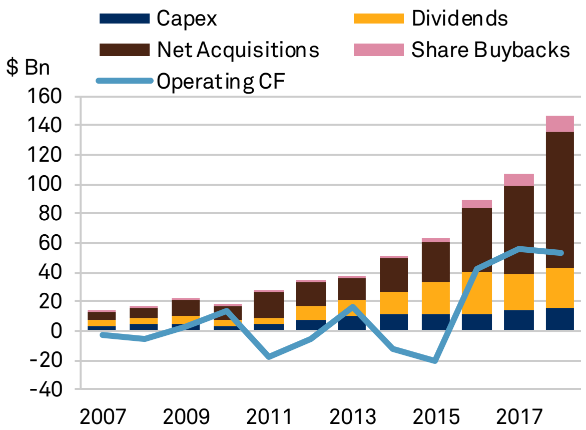


Chart 12

Return on capital employed

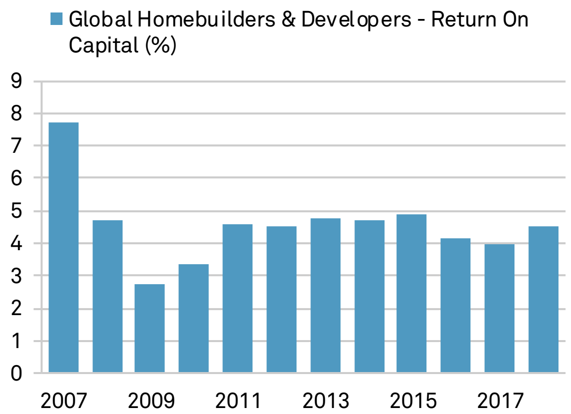


Chart 13

Fixed versus variable rate exposure

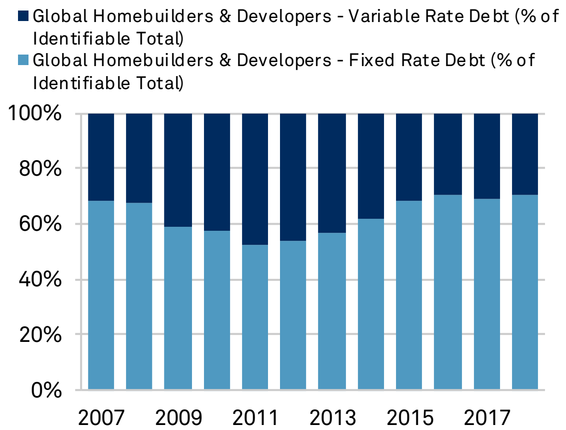


Chart 14

Long term debt term structure

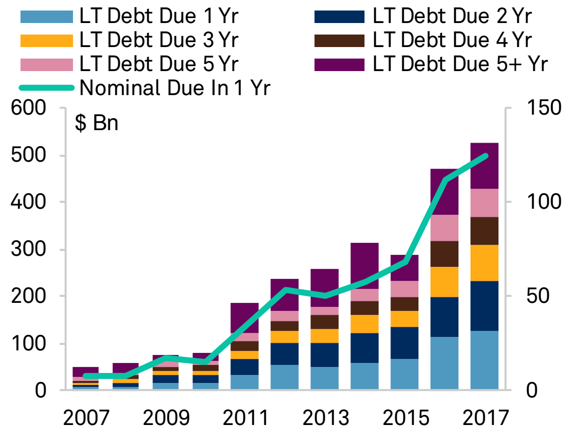


Chart 15

Cash and equivalents / Total assets

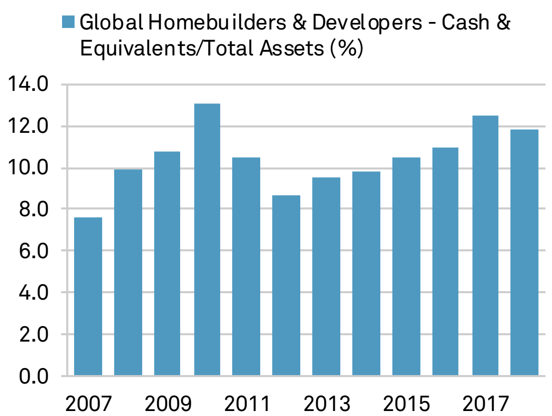
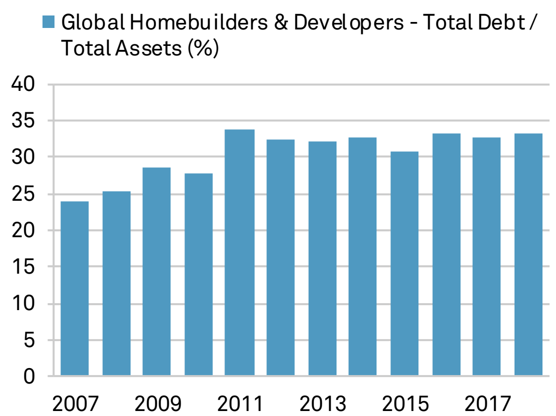


Chart 16

Total debt / Total assets



Source: S&P Global Market Intelligence, S&P Global Ratings calculations

spglobal.com/ratings