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Research Update:

Welltower Inc. Outlook Revised To Positive On Industry Tailwinds And Materially Improved Credit Metrics

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Rating Action Overview

- Welltower Inc. continues to benefit from strong industry tailwinds and has materially strengthened its balance sheet by funding growth almost entirely with equity the past few years.
- We expect the company's key credit metrics will improve further over the next two years, with debt to EBITDA declining to the mid-4x area and fixed-charge coverage (FCC) rising to the mid- to high-4x area.
- We revised our outlook to positive from stable and affirmed all our ratings on the company, including our 'BBB+' issuer credit rating.
- The positive outlook on Welltower reflects our view that the company's senior housing operating property (SHOP) assets will continue generating robust same-property net operating income (NOI) growth in both 2024 and 2025, leading to sustained improvement in its key credit metrics.

Rating Action Rationale

Favorable sector tailwinds and solid asset quality support strong continued operating performance. As of March 31, 2024, Welltower generated 67.1% of its adjusted annualized NOI from senior housing properties, including 51.5% from SHOP assets. Welltower's overall portfolio generated 12.9% same-property NOI growth year over year (with 25.5% growth in SHOP), supported by the combination of better-than-expected pricing power, moderating cost pressures, and occupancy gains. This was the sixth consecutive quarter in which SHOP same-property NOI growth exceeded 20%, and we project continued strong results over the next several years due to industry tailwinds. While these tailwinds will benefit all health care facility types, they should have an outsized positive impact on senior housing. Still, Welltower's sizable exposure to SHOP healthcare assets could result in higher volatility relative to other property types.

Welltower's portfolio is benefiting from the growing number of people aged 80 and older (a cohort that is expected to increase by a compound annual growth rate of 4% until 2050) given its outsized exposure to high-quality and well-operated SHOP assets. Meanwhile, supply growth will likely be muted for at least the next three years because rising construction costs and tighter bank lending have limited new starts. We think this combination will drive same-property NOI growth for Welltower's SHOP portfolio of approximately 20% in both 2024 and 2025, with total portfolio same-property NOI growth of 10%-12% in each year.

We expect credit protection measures will improve further from strong expected operating performance and continued equity issuance to partially fund new investments. Despite the negative impact that the pandemic had on its portfolio (particularly the senior housing operating assets), Welltower's commitment to strengthening its balance sheet has been noteworthy. In 2020, Welltower sold over $3.7 billion of assets, cut its dividend by 30%, and raised nearly $600 million of common stock to preserve liquidity and shore up its balance sheet. It then pivoted to offense in 2021 as it identified myriad accretive investment opportunities, but its commitment to strengthening its balance sheet only amplified. From 2021 through the first quarter of 2024 (including investments currently under contract), Welltower issued $14.4 billion of common stock to fund $16.9 billion of new investments.

As a result, its S&P Global Ratings-adjusted debt to EBITDA improved materially to 5.0x as of March 31, 2024, from 7.4x a year prior (and 8.3x at its peak two years ago). While we expect equity issuance to slow in future quarters, we think the company is likely to continue funding its growth with a healthy proportion of equity. Moreover, strong expected operating performance should drive further improvement to Welltower's key credit metrics given the strong projected organic growth to EBITDA. Welltower had a large cash balance at the end of the first quarter that will largely go toward funding acquisitions under contract. Therefore, we project adjusted debt to EBITDA to remain relatively flat at around 5x for the remainder of 2024 before declining to the mid-4x area in 2025. Coverage metrics are also expected to benefit from strong EBITDA growth, with fixed-charge coverage improving to the mid- to high-4x area (from 3.3x as of March 31, 2024) by year-end 2025.

Outlook

The positive outlook on Welltower reflects our view that the company's SHOP assets will continue to exhibit significant sequential improvement from the March 2021 trough in occupancy, generating robust same-property NOI growth in both 2024 and 2025. As a result of the strong expected operating performance, combined with investments funded in a leverage-neutral manner, we expect Welltower's adjusted debt to EBITDA to remain around 5x in 2024 before declining modestly to the mid-4x area in 2025. We project FCC to improve materially from EBITDA growth, rising to the mid- to high-4x area over the next two years.

Downside scenario

We could revise our outlook back to stable if:

- Favorable operating trends reverse, with senior housing occupancy failing to continue its projected recovery back to pre-pandemic levels, impairing our view of the business and Welltower's outsized exposure to SHOP assets; or
- Credit protection measures fail to improve, perhaps as a result of debt-financed acquisitions, with adjusted debt to EBITDA sustained well above 5x.

Upside scenario

We could raise our ratings by one notch over the next two years if:

- Welltower demonstrates conservative financial policies, with adjusted debt to EBITDA approaching 4.5x and FCC exceeding 4x on a sustained basis; and
- Operating performance remains healthy, with continued sequential occupancy gains, stable to improving margins and robust same-property NOI growth.

Company Description

Welltower is the largest health care REIT and one of the largest REITs we rate, with about $48.3 billion in undepreciated real estate investments and a total enterprise value of about $68.9 billion as of March 31, 2024. The company owned 2,096 properties in the U.S., the U.K., and Canada at the end of first-quarter 2024, consisting primarily of senior housing properties, outpatient medical properties, and skilled nursing facilities (SNFs).

Our Base-Case Scenario

- U.S. real GDP grows 2.5% in 2024 as the labor market remains sturdy, followed by 1.5% growth in 2025.
- The economy transitions to slightly below-potential growth over the next couple of years, which will cause demand for labor to slacken further and lead to a gradual uptick in the unemployment rate to 4.3% by the end of 2025 from 3.9% currently (consensus estimates of the longer-run steady state are clustered at 4.0%-4.4%).
- Inflation will remain above (but approach) the Federal Reserve's target of 2% through 2024, reflecting persistently higher service price inflation, even as goods prices ease modestly.
- Above-target inflation will limit the Fed's ability to ease rates this year. It eases 125 basis points (bps) next year, but we believe the pace could ease at a slower rate in 2024 and 2025.
- Low-double-digit same-property NOI growth in each of the next two years, driven by continued strength in the company's senior housing operating assets.
- Acquisitions of $4 billion-$5 billion in both 2024 and 2025.
- Development funding of approximately $1 billion annually.
- Dispositions of $500 million-$1 billion per year.
- Equity issuance to fund new investments in a relatively leverage-neutral manner.
- Dividend distributions of approximately $1.4 billion-$1.6 billion per year.

Table 1

Welltower Inc.--Forecast summary

Industry sector: Real estate investment trust or company

(Mil. $)	2022a	2023a	2024e	2025f	2026f
EBITDA	2,121	2,450	3,000-3,100	3,700-3,800	4,300-4,400

Table 1

Welltower Inc.--Forecast summary (cont.)

Industry sector: Real estate investment trust or company

(Mil. $)	2022a	2023a	2024e	2025f	2026f
Debt	15,638	15,236	15,250-15,750	17,000-17,500	18,750-19,250
Adjusted ratios					
Debt/EBITDA (x)	7.4	6.2	4.8-5.3	4.3-4.8	4.2-4.7
Debt fixed-charge coverage (x)	3.1	3.1	3.7-4.2	4.4-4.9	4.7-5.2
Debt/debt and undepreciated equity (%)	34.7	29.9	25-30	26-31	27-32

All figures include S&P Global Ratings adjustments' unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Welltower's liquidity as strong. Our assessment of the company's liquidity profile incorporates the following expectations and assumptions:

- Liquidity sources will exceed uses by at least 1.5x over the next 12 months;
- Liquidity sources less uses will be positive, even if forecast EBITDA declines 15% (a REIT-specific threshold for strong liquidity);
- Sufficient covenant headroom for forecast EBITDA to decline 15% without the company breaching covenant tests, and debt is at least 15% below covenant limits;
- The likely ability to absorb high-impact, low-probability events without refinancing;
- A generally high standing in the credit markets; and
- Well-established relationships with banks.

Principal liquidity sources

- Unrestricted cash and cash equivalents of approximately $2.4 billion as of March 31, 2024;
- Full availability under the company's $4 billion revolving credit facilities that mature June 2025 ($3 billion tranche) and June 2026 ($1 billion tranche). Both tranches offer two six-month extensions at the company's option; and
- Funds from operations of about $2.5 billion to $3.3 billion over each of the next 12 month periods.

Principal liquidity uses

- $1.25 billion of senior unsecured notes maturing June 2025 and $10 million due September 2025;
- Principal mortgage amortization payments of about $60 million to $75 million per year;
- Maintenance capital expenditure of about $100 million annually;
- Subsequent to first quarter end, investments under contract totaled $2.6 billion;
- Unfunded development of about $925.6 million as of March 31, 2024; and

- Common dividends of $1.4 billion to $1.6 billion per year.

Covenants

Requirements

As of March 31, 2024, Welltower was comfortably in compliance with all of the applicable covenants on its unsecured debt. We believe the company will maintain sufficient cushion under its covenants over the next 12 to 24 months.

Compliance expectations

The requirements under Welltower's unsecured senior notes as of March 31, 2024 (covenants are reported one quarter in arrears), were:

- Leverage ratio not to exceed 60% (Welltower reported 26.4%);
- Secured debt ratio not to exceed 40% (3.8%);
- Interest coverage ratio greater than 1.5x (4.19x); and
- Unencumbered assets to unsecured debt ratio greater than 150% (398.9%).

Issue Ratings - Subordination Risk Analysis

Capital structure

For real estate, we typically rate the senior unsecured debt the same as the issuer credit rating unless the percentage of secured debt exceeds 35% of total undepreciated assets.

Analytical conclusions

Most of Welltower's properties are unencumbered, and the ratio of secured debt to total undepreciated assets was 3.8% as of March 31, 2024, which is well below the threshold of 35%. Therefore, we rate the company's unsecured debt 'BBB+', the same as the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Positive/A-2

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Liquidity: Strong (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Real Estate Monitor: Higher-For-Longer Interest Rates Will Continue To Weigh On The Sector, March 20, 2024

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Welltower Inc.		
Issuer Credit Rating	BBB+/Positive/A-2	BBB+/Stable/A-2
Welltower OP LLC		
Issuer Credit Rating	BBB+/Positive/--	BBB+/Stable/--
Ratings Affirmed		
HCN Canadian Holdings-1		
Senior Unsecured	BBB+	
Welltower OP LLC		
Senior Unsecured	BBB+	
Commercial Paper	A-2	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.