Stable Property Outlook Despite Economic Downturn and New Regulations

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PEFINDO is of the view that the outlook of the Indonesian property industry is stable in the near to medium term, supported by strong demand, particularly for the residential segment. The economic downturn and new regulations are expected to slow sales growth and also lower the profitability margins of industry players in the near term with various degrees of impact on the property sectors. However, we believe that most of the rated companies in our portfolio have strong financial profiles.

After significant growth for the last three years, less favorable economic conditions such as rising inflation and higher interest rates could reduce demand for property. Table 1 below shows the economic downturn, from favorable figures for the last three years to slower GDP growth and rising inflation, leading to a higher Bank Indonesia (BI) rate. Higher interest rates could hamper purchasing power, particularly for residential products, as the middle-to-low income segment still depends on mortgage loans for housing purchases. Inflation could also increase the construction costs of developers, which will in turn squeeze their profitability margins. Also, the general election in 2014 could cause an uncertain business environment, and a wait-and-see attitude by investors, developers and customers. However, the growth of the property industry will still be supported by strong demand due to the large national housing backlog.

Table 1. Economic Indicators

Indicators	*8M2013	2012	2011	2010
GDP Growth	**5.9%	6.1%	6.0%	6.8%
Inflation Rate	8.8%	4.3%	3.0%	7.0%
BI Rate	7.0%	5.7%	6.0%	6.5%

Source: Bank Indonesia, Statistic Bureau,
*Note: * the first eight months of 2013*
*** as of 1H13*

The property industry, particularly the residential segment, faces challenges from new regulations published by BI to minimize speculative property transactions and lower the rise in housing prices. After the less than successful loan-to-value (LTV) regulation in 2012, BI launched a more specific LTV regulation, as described in Table 2 below, in September 2013. This regulation is expected to minimize customers obtaining more than one housing loan (KPR) facility at the same time by requiring a higher down payment for the second or third properties. BI also issued a regulation restricting indent KPRs, whereby banks cannot disburse mortgage loans before construction is finished for second or third housing ownership. This new regulation will decrease the cash flow of developers as the loan disbursement is one of their main sources of funds, particularly for small developers.

Table 2. Loan to Value Mortgages

Housing / Apartment Type	Loan to Value		
	1st ownership	2nd ownership	>2nd ownership
> 70 sqm	70%	60%	50%
70 sqm	70%	60%	50%
22 – 70 sqm	80%	70%	60%
<22 sqm	-	70%	60%
Shop houses	-	70%	60%

Source: Bank Indonesia

Impact on subsectors

The impact of changes in economic conditions and the new regulations vary between property subsectors, depending on the on key driver of the subsectors' demands and characteristics. We believe that companies with higher recurring income contributions should see a more stable performance. Below is a summary of outlook for each subsector.

Residential

- The implementation of new regulations and higher interest rates could have a negative impact on sales growth for developers, particularly those with a high contribution from KPRs.
- Developers with large land banks, sizable marketing sales, and/or a high contribution of cash transactions (hard cash and cash installment payments) are in a better position, particularly for the next 12-18 months (during the completion of the projects).
- Supported by strong demand due to the large housing backlog.

Retail

- Lower GDP growth and higher inflation followed by weakening domestic consumption could negatively affect demand for retail space as retailers cut back on expansion plans.
- Potentially higher operating costs due to increased electricity tariffs, which could be passed on to tenants.
- Stable revenue from a stable rental rate increase.
- The Jakarta governor's moratorium that limits the supply of retail space could be followed by higher rental rates.
- The recent sizable demand from international branded retailers such as Lotte, Uniqlo, and H&M.
- Retail space supply could shift to suburban Jakarta, such as Bekasi, Serpong, Bogor and Depok.
- The retail space occupancy rate in Jakarta is relatively stable at around 90%.

Offices

- Lower GDP growth and the general election in 2014 could hamper demand for new office space as companies delay their expansion plans.
- Potential higher operating costs due to increased electricity tariffs and minimum wages, which could be passed on to tenants through higher service charges.
- A limited supply of office space in the central business district (CBD) due to a limited land bank, and the rebuilding of some existing buildings in the CBD to pursue a higher grade office lease at a higher rental rate.
- Potential oversupply of office space in non-CBD areas such as TB Simatupang in 2016.
- The occupancy rate of office space in Jakarta is relatively stable at around 95%-98%.

Industrial Estates

- Expansion activities are slowing in anticipation of the general election in 2014.
- Automotive and manufacturing industries are still actively looking for land for expansion.
- Land scarcity remains the main obstacle for the purchase of industrial property.

Hotels

- Highly depends on the tourism industry and political stability.
- Slower economic growth will negatively affect business trips and MICE (meetings, incentives, conventions, and exhibitions).
- Potential lower occupancy rates for budget hotels due to the aggressive expansion in the industry as the barrier to entry for budget hotels is lower than luxury hotels.

PEFINDO's property portfolio to remain stable

Profitability figures of the property players in PEFINDO's portfolio have been trending upward for the past five years (2012-2008), as reflected by improved EBITDA margins supported by strong sales growth. During 2010-2012, housing prices increased up to 30% per year while the cost of land remained low. Most property companies in our portfolio applied a pre-selling strategy to reduce the risk of unsold products, alleviating financing costs, and maintaining a positive cash flow. External financing was needed only to fund the projects sold on a rental basis or to build the supporting infrastructure. Therefore, the leverage level and cash flow protection ratios gradually improved during 2008-2012, as described in Table 3.

Table 3: Average Financial Indicator of PEFINDO's Property Portfolio

Ratios	1H13	2012	2011	2010	2009	2008
[%] EBITDA Margin	35.6%	30.8%	28.0%	27.3%	25.8%	20.0%
[%] EBIT Margin	32.4%	27.4%	24.0%	23.5%	21.2%	16.6%
[%] Net Income Margin	23.6%	19.7%	14.8%	15.1%	7.1%	7.0%
[X] Debt to Equity Ratio	0.4	0.4	0.4	0.6	1.0	1.0
[X] Adjusted Debt to EBITDA	1.5	2.2	2.8	3.6	6.2	10.4
[X] EBITDA to Total Debt	0.6	0.6	0.6	0.4	0.3	0.2
[X] EBITDA to IFCCI	9.2	7.7	5.0	3.9	(1.2)	2.1

Source: Financial Statements, PEFINDO Database
Note: Some accounts have been reclassified according to PEFINDO definitions *IFCCI= interest, financial charges, and capitalized interest*

We expect moderate sales growth for the 12-18 months ahead as our rated companies will realize their sizable marketing sales. Based on our data, some of the companies still recorded strong growth in marketing sales up to 3Q2013. PEFINDO believes that the impact of the currently less favorable economic conditions on the rated companies has not been significant enough for any rating revision, and the outlook for most of our rated companies is stable. We even placed a positive outlook for PT Modernland Realty Tbk (MDLN), reflecting our expectation of stronger cash flow protection in the near term due to the sale of 170 hectares (ha) of land bank reserves in Tangerang worth IDR3.4 trillion, which will be paid in 30 monthly installments, and expected additional sales from the Jakarta Garden City project.

However, we will closely monitor the financial profiles of our rated companies, particularly for any possibility of weakening cash flows and more aggressive financial leverage levels after the implementation of the KPR indent restriction. Property players use pre-selling payments to finance working capital, and smaller companies have less flexibility in obtaining external funding during less favorable economic conditions. In addition, we will monitor their achievement of marketing sales targets in 2014 following potential weakening demand. Given these circumstances, liquidity and financial flexibility will be highly important to maintain the financial viability of property companies.

Table 4: Property Companies Rated by PEFINDO

Rank	Company	Property Segment	Rating/Outlook
1	PT Bumi Serpong Damai Tbk (BSDE)	Residential, Retail, Hotels	AA-/Stable
2	PT Summarecon Agung Tbk (SMRA)	Residential, Retail, Hotels	A+/Stable
3	PT Agung Podomoro Land Tbk (APLN)	Residential, Offices, Retail, Hotels	A/Stable
4	PT Surya Semesta Internusa Tbk (SSIA)	Industrial Estates, Hotels, Offices	A/Stable
5	PT Intiland Development Tbk (DILD)	Residential, Offices, Hotels	A/Stable
6	PT Modernland Realty Tbk (MDLN)	Residential, Industrial Estates, Hotels	A-/Positive
7	PT Wika Realty (WKTY)	Residential	A-/Stable
8	PT Duta Anggada Realty Tbk (DART)	Offices, Retail	A-/Stable
9	PT Perdana Gapuraprima Tbk (GPRA)	Residential, Offices, Hotels	BBB+/Stable

Source: PEFINDO Database